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COMMISSION'S ACTIVITIES DESIGNED TO ASSIST THE INTEGRATION OF THE COUNTRIES IN TRANSITION INTO THE EUROPEAN AND GLOBAL ECONOMY

Note by the Executive Secretary

Introduction

1. The primary objective of the operational activities of the United Nations system, including the regional commissions, is to promote self-reliance of recipient countries through multilateral cooperation. The fundamental characteristics of these operational activities is their universal, neutral and gratuitous nature and their ability to respond to the needs of recipient countries in a flexible manner. They constitute a critical and unique resource in enabling countries with economies in transition to exercise the leading role in the management of their own transition processes for the integration into the world economy i.e. to internalize transition within an enabling environment created by coordinated and supportive action by ECE, the United Nations system and other multilateral assistance efforts of the organizations active in the ECE region.

2. In the past the regional commissions provided less than 5% of the overall assistance to recipient countries. The most recent decentralization efforts resulted in an increase of resources available for the regional operational activities, primarily advisory services and fellowship programmes. In view of Commission decision B (49) efforts were made to diversify forms and methods of the operational activities and to strengthen cooperation with the United Nations system using the established mechanism of the Consultative Committee on Programme and Operational Questions (CCPOQ) and through increased consultations with the United Nations Secretariat, UNDP, UNCTAD, ILO, UNIDO, IAEA and non United Nations entities: the European Union, OECD, CSCE, EBRD etc., which have resulted in reinforcing the existing forms of assistance and developing new modalities of cooperation as presented briefly in this report.

A. Programme of workshops

3. Owing to the increased demand for workshops and to the decision of the forty-ninth session of the Commission to continue and strengthen the programme of workshops and seminars, the ECE secretariat has made efforts to provide a summary evaluation of recent workshops. The aim is to improve the effectiveness and efficiency of future workshops, based on lessons learned from past experiences.

4. Since the programme began in May 1990 a total of 145 workshops as of 31 December 1994 have been held on economic transition issues in the following fields: human settlements; environment; industrial development; energy; transport, communication and tourism; statistics; international trade and development finance; development issues and policies; food and agriculture; forestry and timber.

5. Efforts have also been made to secure an interdisciplinary approach and to introduce new subjects which could be illustrated by workshops on issues as varied as the reconversion of coal-mining regions; gender; and ageing.

6. Any overlap with the activities of other international organizations and institutions in the region has been carefully avoided and many of them, such as the programmes of EUROSTAT (ECE/OECD/CEE) and PHARE (CEE), UNDP, FAO, UNFPA, GATT, IMC, ITC, OECD, UNIDO, UNCHS, UNDP, World Bank and WHO, are currently cooperating with ECE on the workshops. Workshops are also expected to be held with OECD, if resources permit.

7. The flexibility of the programme of workshops, in terms of choice of major themes and topics and organizational modalities, has enabled the programme to continue its upward trend.

8. Nine workshops were held in 1990, 27 in 1991, 35 in 1992 and 39 in 1993 (6 workshops from 1 January 1993 to 30 March 1993 and 33 workshops from 1 April 1993 to 31 December 1993). During the period of the Commission session from 1 April 1993 to 15 April 1994, 35 workshops were held.

9. From 16 April 1994 to 31 March 1995 43 workshops were held or planned under ECE auspices. However, there is a great difference in terms of the number of workshops from one subject area to another: of the total 40 workshops, 7 related to energy, 8 to industrial development, 8 to human settlements, 8 to environment, 4 to food and agriculture, 4 to forestry and timber, 2 to statistics, 1 to development issues and policies, 1 to transport, 1 to assistance to the newly independent States, 2 to advancement of women and 1 to ageing issues.

10. Compared to the previous period (1993-94), the number of workshops in 1994-95 increased 25% (100% increase in countries in transition (CITs), 23% decrease in market-economy countries). But the number of host countries has declined both in countries in transition and in market-economy countries (from 23 to 17), with the result that more workshops were held in fewer countries.

11. During this period, 34 workshops were hosted by 10 countries with economies in transition: 10 by Hungary; 5 by the Russian Federation; 4 by Belarus; the Czech Republic, Romania and Ukraine hosted 3 workshops each,

while Poland and Slovakia hosted 1 workshop each. Estonia and Slovenia were host countries for 1 workshop. Seventeen workshops were held in 7 western countries: 6 in Switzerland, 3 in the Netherlands, 3 in Germany, 2 in Austria and 1 in France, Greece and Spain.

12. From the perspective of the host countries, reduction in the availability of resources for workshops was registered. Central and east European countries have shown a preference for organizing workshops on specific subject areas which could attract partners who could secure funding for concrete follow-up. Some workshops are organized at Geneva in conjunction with regular ECE meetings in order to save on travel expenses.

13. As previously reported the character of the workshops varies according to the objectives: (a) workshops for the exchange of general information on the transition process and for the training of nationals of countries in transition by experts from market economies; (b) workshops to provide national authorities with advice or international expertise on the development or implementation of concrete national legislation or policies; (c) workshops to tackle problems relevant to all countries of the ECE region or to prepare regional programmes to be submitted to outside donors for financial and technical assistance.

14. During the period April 1993-March 1995 most ECE workshops had a strong training component, so as to facilitate the transfer of knowledge, skills and expertise, and support national capacity-building. These workshops respond to the emerging needs of countries in transition for training and learning through sharing experiences and information.

15. Participants in recent ECE workshops also suggested continuing the programme of workshops, especially as a form of training and exchange of practical country-based experience, and expressed the opinion that future workshops should concentrate more on the solution of practical problems through technical visits and make recommendations for more concrete follow-up.

16. The decision to hold a workshop, as well as the choice of topic, is generally demand-driven and is not necessarily tied directly to the Commission's programme of work and calendar of events. However, there is a close interrelationship between individual workshops and elements of the ECE regular work programme, which is being implemented in close cooperation with its member States.

17. Owing to the close interrelationship between the ECE programme of workshops and each principal subsidiary programme of work (i.e. with elements to which the Committees also assigned high priority), conclusions of workshops are regularly submitted and evaluated by PSBs. They provide specific and practical recommendations for the follow-up activities adopted by the major subsidiary bodies.

18. The ECE workshop programme is financed either through extrabudgetary resources or to a large extent by the countries in transition themselves. It is often supported by the business community and by bilateral contributions in cash or in kind from government and private sponsors in market economies.

19. The UN/ECE Trust Fund for Assistance to Countries in Transition (TFACT), established to ensure that all member States could participate fully and

effectively in the work of ECE, provides a channel through which Governments, international organizations, institutions and other donors may contribute funds to help countries in transition and newly independent States to defray the costs of their participation in ECE meetings, including its workshops.

20. There is a need to consider the differences between the countries at an advanced stage of transition (central and eastern Europe) and those in the early stages of transition (newly independent States). These two categories have different problems and requirements.

21. Once needs have been well defined, ECE should keep supporting the choice and design of workshops, including setting up the agenda, securing lecturers and participants, providing organizational support, including the search for financial contributions. These multiple tasks as well as an increasing demand for more workshops impose the necessity to coordinate approaches with other international, regional and subregional institutions to secure the continuation and further growth of the workshop programme and the follow-up. This has been actively pursued by the ECE secretariat.

B. Advisory services

22. In the context of the restructuring of the United Nations secretariat in the economic and social sectors, ECE, starting from July 1994, established its regional advisory service programme which provides member countries in transition to a market economy, on their request, with advisory services in areas that they themselves identify as being the greatest need. The programme aims at providing Governments with information and advice on existing programmes, services and data in areas that they have designated as priorities. It promotes the capacity and institution building of member Governments to facilitate their integration into the European and world economy.

23. The programme interacts closely with the programmes of work of the Commission and of its Principal Subsidiary Bodies and focuses in particular on assisting Governments in implementing strategies, policies, legal instruments and standards prepared within the framework of the ECE.

24. ECE provides advisory services in transport, statistics, environment, trade, trade facilitation, energy, forestry and forest products, industrial development and in development issues and policies. Within the context of the programme for the period 1 July 1994-31 January 1995, the regional advisers have carried out a total of 46 missions. Countries in transition visited included Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Latvia, Lithuania, Poland, Republic of Moldova, Romania, Russian Federation, Slovakia, Slovenia, the former Yugoslav Republic of Macedonia and Ukraine. Assistance was given in the identifying needs, identifying and preparing projects to assist in ECE convention implementation, capacity and institution building, and training. Regional advisers have received a considerable number of requests for advisory missions to practically all member States in transition to a market economy. To mobilize resources for particular projects, they also undertake fund- raising missions to donor countries and to the international organizations with assistance potential.

25. The Regional advisers generally work in consultation and cooperation with the corresponding resident representatives of the United Nations or UNDP, aiming at synergism of the efforts of the United Nations system.

26. Under the auspices of the programme, on 14 and 15 December 1994 the ECE secretariat organized a workshop on the role and functions of the ECE for the newly independent States of the former Soviet Union - countries in transition, having little or no experience of cooperation with ECE. The meeting was at the ministerial level and provided both participating member States and the secretariat with an opportunity to discuss the role and functions of ECE, especially concerning assistance to the countries in transition to a market economy. At the round table discussion within the framework of the workshop, the participants exchanged views on the relevance of the work and assistance of ECE to their countries and on the modalities of such assistance, in particular the assistance of the regional advisory service. The participants were unanimous in appreciating the assistance efforts of the Commission.

27. The group of countries represented at the workshop indicated that, while they appreciated the general direction of the current work of ECE, at this stage of development they had specific needs and priorities. In particular the issues of energy, transport, industrial development, agriculture, privatization and conversion of military enterprises for civilian uses were at the top of their current development agenda. They also underlined that at the present stage of economic reforms in their respective countries the task of paramount importance was the preparation of bankable projects, which could win the financial support of national and international investors.

28. The suggestions made by the participants in the workshop have been studied and will be incorporated, as practicable, into the work of the ECE secretariat and its regional advisory service. In particular, in relation to the promotion of foreign direct investments, it was suggested that the regional advisory service should explore ways of assisting countries in transition in finalizing their projects, so that they conform to the format and criteria accepted by international financial institutions.

29. The regional advisory service has also worked out a national programme of focused assistance to the Republic of Georgia. The first phase of the programme is scheduled to be implemented before the end of July 1995. The experience of this programme will be evaluated and applied to other cases of high priority.

30. The ECE secretariat is exploring possibilities for further intensifying cooperation of its regional advisory service with other relevant organizations, in particular with UNDP, the Commission of the European Communities, and international financial institutions, with the objective of fully utilizing existing strengths and exploiting complementarities so as to achieve synergy in assisting the countries in transition in the preparation of projects of international assistance in their transition to a market economy.

C. Fellowships

31. A portion of section 20 of the United Nations budget secured some modest financial means for fellowships. The new instruction geared to introducing innovations into the United Nations fellowship programme enabled the ECE

secretariat to use the funds for securing participation of experts at ECE workshops and expert meetings.

D. National capacity strengthening training programme

32. General Assembly resolution 47/198 on triennial policy review of the operational activities of the United Nations system emphasized the necessity of developing common innovative and integrated system-wide training programmes, taking into account the use of regional cooperation management, for government officials and other nationals. Training programmes should, inter alia, include schemes for the training of national trainers. This decision complements Assembly resolution 48/181, which places emphasis on human resource development in countries in transition.

33. CCPOQ entrusted the International Training Centre of ILO in Turin with developing a training programme on the Management of development: national capacity strengthening, the objective of which is to help meet needs in a cost-effective manner through a "training of trainers" programme intended for national staff, to obtain a multiplier effect, and by establishing a network of training institutions. The training programme has benefited from the initial financial support of several donors, particularly the Governments of Italy, Germany and Switzerland.

34. Special features of the programme include the production, validation, testing and use of training material, including self-assessment computerized questionnaire (SAIL). So far several training modules have been fully developed including policy analysis and planning, introduction to organizational development, project formulation, budgeting, review and control for projects and project management. Other self-sustained modules are foreseen e.g. on the relationship between national entities and development partners.

35. The current programme of the ILO Turin Centre includes regional programmes based on region-specific priorities. The regional programme for the ECE region includes primarily national capacity strengthening and areas related to the ILO programme.

36. Following Commission decision B (49), contacts with the ILO Turin Centre were strengthened to explore the possibilities of future cooperation related to the ECE programme of work and demands expressed by countries with economies in transition. The initial cooperation could be launched in the field of energy efficiency, natural gas and establishment of small and medium enterprises by preparing training of trainers manuals.

37. Existing interagency training modules could be further adjusted to the specific regional needs of countries with economies in transition to include financial engineering and business management training.

38. During the second meeting of the European Regional Representatives of ACC members held at Geneva on 6 February 1995 and chaired by ECE, with the participation of IMF, IBRD, EBRD, Council of Europe, Commission of the European Communities, the strengthening of training efforts for the benefit of economies in transition was considered. It was recommended that the proposals for elaborating training materials/modules would be developed by the

participating institutions. The ILO will spearhead these efforts in close consultation with ECE.

E. Preliminary list of experts and specialists in the problems of privatisation and of transition to market conditions

39. In its decision B (49) the Commission requested the Executive Secretary to undertake necessary steps to implement the proposals contained in his report with special attention to the establishment in consultation with Governments of all interested member countries, the Commission of the European Communities, international organizations and private bodies, of a list of experts and specialists in the problems of privatisation and of transition of different economic sectors to market conditions, whose services could be offered to interested countries in transition, providing advisory services in the areas of environment, transport, statistics, trade facilitation, energy, development of international trade, industry and technology, and agriculture and timber.

40. In response to the Executive Secretary's request addressed to member countries, the Commission of European Communities, relevant specialized agencies, intergovernmental and non-governmental organizations for names and addresses of experts and specialists in the above-mentioned areas for inclusion into the ECE list, as of 6 February 1995 the secretariat had received replies and information from 12 member countries, namely Austria, Belarus, Belgium, Czech Republic, Germany, Greece, Finland, Lithuania, Malta, Poland, Switzerland and the United Kingdom, as well as the World Trade Organization. In order to enable the interested parties to benefit from the information before all the replies to the ECE request come in, and also to receive possible comments and suggestions as to the presentation of the list, a preliminary version of the list has been compiled. The final version will be issued when the ECE secretariat receives an adequate volume of additional information, but no later than 31 December 1995.

F. Cooperation with the United Nations Development Programme

41. The Secretary General's intention to strengthen the role of the regional commissions and later to integrate them into the work of the Organization resulted in a series of meetings with the United Nations senior officials.

42. A growing body of discussions related to global programmes of the Organization created common ground for cooperation in the United Nations system and member States, including the preparation of country strategy notes. The resident coordinator system of UNDP has been entrusted with responsibility emanating from resolutions and decisions of the General Assembly and ECOSOC. The system should also foster enhanced collaboration with the World Bank, IMF and other international financial institutions. In view of new guidelines on the role and functioning of the resident coordinator system, the ECE secretariat has reinforced its interaction with resident coordinators, including the possibility of organizing regular annual meetings for securing the ECE support to regional and country programming processes.

43. A Regional Economic Commissions/UNDP Task Force has been established, which examines the regional structure of UNDP programmes and discusses measures to strengthen cooperation between UNDP and the regional commissions. It has been suggested that regional commissions be invited to the regional

meetings of resident coordinators. For the ECE region the meeting will take place in Ankara and ECE has been invited to attend.

44. During the fifth session of CCPOQ a general policy review of present and emerging requirements of recipient countries was reviewed. Related to the triennial policy review of operational activities for development, 14 countries were selected for in-depth country missions based on detailed questionnaires. In the ECE region Belarus, Uzbekistan and Turkey were selected for that review and ECE might be required to provide some inputs.

45. ECE could also cooperate with the system of resident coordinators within the region to support the preparation of the country strategy notes aimed at securing coordinated approach among different donors.

F. Cooperation with the Department of Development Support and Management Services of the United Nations Secretariat

46. In 1994 a decision was taken by the Secretary-General to secure the joint management among five regional commissions and DDSMS of the United Nations Secretariat technical cooperation programme related to natural resources and energy.

47. Ways of organizing this cooperation will be discussed at a meeting of the executive secretaries of the regional commissions and the Under-Secretary General of DDSMS. The preliminary proposals would include joint programming missions of relevance to several regions, joint use of available technical support funds for programming purposes, follow-up to ECE regional advisers missions and support to ECE workshops. This cooperation provides only modest financial possibilities for increasing assistance to economies in transition, but will increase interaction and cooperation among regional commissions in the field of national resources and energy.

G. Cooperation with the Economic and Social Commission for Asia and the Pacific

48. The Asian republics of the former Soviet Union are members of both ECE and ESCAP, which requires close cooperation between the two commissions, including joint solutions to some legal interpretations related to technical assistance. The process of consultation is under way, including regular exchange of information on operational activities relevant to both commissions. A concrete effort in joint programming has also been also launched related to the implementation of the ECE Convention on Transboundary Waters and International Lakes.

CONTRIBUTIONS BY ECE DIVISIONS TO OPERATIONAL ACTIVITIES

49. The ECE secretariat intends to pursue this cooperation in a more integrated manner in close ongoing consultations with the organizations concerned.

Policy Analysis and Projections

50. The Workshop on Public Investment Recovery in Transition Economies (Sinaia, Romania, 4-6 October 1994) covered a broad range of public sector activities in the economic and social fields. Its conclusions, in particular

on financing, could be of relevance to programming of future operational activities.

51. The Workshop on Transboundary Cooperation in the Geo-Economic Sub-region Bratislava-Gyor-Vienna, to be held at Bratislava in 1995 will open possibilities of subregional technical cooperation in different fields, including investment possibilities.

52. As reported under the ECE contribution to global programmes, ECE has developed a plan to assist economies in transition in the immediate follow-up of the International Conference on Population and Development. Accordingly ECE has appointed a regional adviser for a six-month period to assist with the finalization and implementation of the plan.

Statistics

53. The programme of work of the Conference of European Statisticians has been substantially adapted to assist in the integration of countries in transition. However, many of these, and in particular the newly independent States, are prevented from participating in ECE work because of lack of financial resources. The Statistical Division has therefore been able to use PHARE and to a lesser extent TACIS funds through Eurostat, thereby ensuring a fuller participation at different meetings.

54. The appointment of a regional adviser in economic statistics in May 1994 has enabled ECE to provide direct assistance to a number of countries in transition. The work of the adviser has been closely coordinated with related assistance provided by OECD, Eurostat, IMF and others.

55. The Statistical Division has also embarked on a major project with UNDP. ECE is the executing agency for a three-year programme of technical assistance in social and demographic statistics to countries in transition and in particular to the newly independent States of the former Soviet Union. The project is being planned in close cooperation with a number of donor countries, with the Commonwealth of Independent States (CIS) Statistical Committee and with the Slovak Statistical Office.

56. Another good example of interagency cooperation is the assistance provided under the auspices of the Council of Europe and of Eurostat, to the former Yugoslav Republic of Macedonia in their special population census in 1994.

Trade

57. The Workshop of the CIS and Baltic States on regional trade, payments and economic cooperation (Chisinau, Republic of Moldova, 9-12 January 1995) is an example of cooperation with UNDP, UNCTAD and ITC in providing assistance to economies in transition.

58. A Seminar on Trade Facilitation and Countries in Transition held at Geneva on 19 September 1994 considered the priorities for action in this area, including improved coordination of international organizations to respond better to these priorities.

59. Two Regional Advisers have been appointed in the Trade Division, one for trade policy and investment and the other for trade facilitation. Since July 1994, missions have been carried out to Bulgaria, Republic of Moldova, Romania, Russian Federation and Slovenia.

60. The Trade Division is cooperating with the European Commission's PHARE and TACIS programmes to integrate the recommendations, standards and guidelines developed through the working parties of the Committee on the Development of Trade into the technical assistance projects they undertake. Discussions have been held with EBRD, and the World Bank, as well as several bilateral technical assistance agencies toward the same objective.

Environment

61. Workshops organized in the field of environment during the period under review included such topics as environmental policies; environmental performance reviews; identification and screening of hazardous activities; strengthening the capability of future parties to comply with the obligations under the Convention on Environmental Impact Assessment in a Transboundary Context; bilateral and multilateral environmental impact assessment in a transboundary context and privatization and the environment process.

62. Market economy countries have financed these workshops either directly or through TFACT. In order to strive for synergy and avoid duplication with other international organizations and institutions, several workshops were organized in 1994 in cooperation with other institutions such as OECD on environmental performance reviews and with the PHARE programme on land registration and cadastre.

63. Through the regional adviser on environment, short-term advisory services are being provided for technical cooperation in pilot projects and training activities to assist countries in transition in adapting relevant policies, instruments and practices to comply with the regional environmental conventions. During the period under review half the countries in transition were visited, environmental problems identified, opportunities for assistance discussed and steps taken for follow-up action.

64. Special attention is being given to private-sector development, enterprise management (self-control, safety culture, responsible care approach) and to the strengthening of capabilities for environmental management accounting and auditing at enterprise level.

65. Preparations are under way to provide technical assistance to countries in transition for implementation of the ECE Convention on Transboundary Waters and International Lakes. A proposal to assist central Asian countries that will become Parties to the Convention in monitoring has been submitted to DDSMS. It is expected that assistance to other countries in transition will also be provided through similar projects to help them overcome problems in implementing the Convention.

66. Two ECE regional coordinating centres have been established under the Convention on the Transboundary Effects of Industrial Accidents aimed at setting up a network of national centres in the ECE region, in particular in countries in transition in order to help them to reduce the risks of

industrial accidents and to strengthen their capabilities to prepare for and respond to such accidents.

Transport

67. The work in transport, including the legal instruments developed under the auspices of ECE, has proved very useful to the countries in transition. The legal instruments offer these countries a set of norms and standards for possible implementation. In some cases these provisions have been broadened to take into account the needs and concerns of those countries. Monitoring of the implementation of legal agreements is also being introduced.

68. A questionnaire was sent out to the countries in transition on the following matters:

(a) The experience they have acquired up to present with workshops, seminars, etc. dealing with transition-related problems;
(b) Identification of their needs in the transport sector, that are not yet taken care of bilaterally or multilaterally and that would permit a priority ranking of the assistance required from western Governments and international financial institutions and organizations.

69. A report on the methodological basis for the definition of bottlenecks, missing links and quality of service of infrastructure networks was completed. The report should be taken into account in the identification of priority investment projects in CEEC which has been undertaken by the EC in the context of the G-24 Transport Group.

70. The Principal Working Party on Road Transport is currently working on measures aimed at facilitating of international road transport between eastern and western Europe. This should result in the formulation of concrete proposals on solving existing problems relating to border-crossing delays and other hindrances to international road transport.

71. The Working Party on Road Traffic Safety periodically revises legal instruments relating to road traffic and continues exchange of information on road traffic regulations in force in all ECE member countries. This enables countries in transition and, in particular, the newly independent States to adapt their road traffic regulations to those of more advanced economies.

72. The AGR, AGC and AGTC agreements were recognized by the Second PanEuropean Transport Conference as a basis for identifying long-term priority investment projects in central and eastern Europe. In this context the recent work on the inclusion of new international links in that part of Europe will be beneficial to countries in transition.

73. Questionnaires have been sent to all ECE countries to monitor the situation of training of drivers of vehicles carrying dangerous goods. A specific section relates to countries which are not Contracting Parties to ADR, including a large number of countries in transition.

74. Assistance to the CSCE initiated process on the establishment of two TIR transit corridors facilitating international transport and trade to alleviate the repercussions resulting from the embargo against the Federal Republic of Yugoslavia (Serbia and Montenegro).

75. The first ECE-Eurostat Workshop on transport statistics, "The Organization and Automation of Transport Statistics", was held at The Hague, from 13 to 15 June 1994, with the participation of 12 countries in transition: Albania, Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Russian Federation, Slovakia and Slovenia.

76. Advisory services and training were provided at two regional Seminars on the TIR Transit Regime (Budapest, 20-21 September 1994 and Pomporovo, Bulgaria, 5-6 October 1994) financed by the PHARE programme for Albania, Bulgaria, FYROM, Hungary, Romania and Slovenia.

77. The Trans-European North-South Motorway (TEM) and the Trans-European Railway (TER) are projects of the CEEC countries managed through fund agreements for which ECE is the executing agency. The aim is the construction, upgrading and management of selected road, rail and combined transport networks with a view to ensuring reliable, fast and safe transport in this region particularly countries in transition. To this end, the participating countries cooperate in establishing standards, accelerating construction, exchanging know-how and identifying priorities and investment requirements.

78. The Inland Transport Committee at its fifty-seventh session in January 1995 requested all its subsidiary bodies to intensify their work on subjects of special interest to countries in transition. A round-table discussion on assistance to economies in transition might take place during the fifty-eighth session of the Committee in 1996. The programme of operational activities, including future workshops and advisory services is under preparation.

Energy

79. The demand for energy workshops has continued to increase and encompasses a wide range of topics related to market adaptation of coal industries in central and eastern Europe; reconversion of coal-mining sites; reassessment of coal and mineral deposits under market conditions; occupational safety and environmental protection in the underground coal industry; restructuring of electric power industry; cogeneration and district heating; new and renewable sources of energy; energy pricing and energy efficient technology. In addition, ad hoc meetings and symposia were held on energy efficiency standards and energy efficiency demonstration zones.

80. The advisory services started in May 1994 included a wide spectrum of issues such as energy efficiency, legislation for natural resources, coal classification systems and natural gas resources. The advisory services have resulted already in a joint ILO/ECE project in Belarus related to socio-economic revival through de-militarization, funded by UNDP. The project includes military concession, employment promotion, enterprise creation and energy conservation. The main aim of this innovative project is to establish energy efficiency demonstration zones on former military bases for small- and medium-sized enterprises and to use communication facilities for environmental monitoring.

81. The first stage of the Energy Efficiency 2000 programme was successfully completed. During the first three years, the priority of the "Energy Efficiency 2000" project was on increased contacts between businessmen, trade

officials, bankers, engineers and energy managers. The project held 46 meetings and events. Sixteen trade fair events with 4,500 participants, one third of whom were from central, eastern and southern Europe, 730 of whom were supported by the project's Trust Fund resources, with participants from 42 ECE member States taking part in 29 east and west European locations with 132,000 m2 of exhibition space devoted to energy efficient technology. In addition, ad hoc meetings were held on Energy Efficiency Standards (in Geneva) and on Energy Efficiency Demonstration Zones (in Moscow, Rome and Newcastle-upon-Tyne) and Symposia in Bled, Paris, Moscow and Kiev. The participants in the project have been provided with a range of information services published as "East West Energy Efficiency". Some 10,000 copies of these have been disseminated in English, French and Russian. Consultations were held with UNDP on ECE cooperation in the preparatory assistance which will enable the formulation of a programme for transition to funding to the Global Environmental Facility (GEF).

82. Additional results of the project include some bilateral agreements such as the technical cooperation agreement between the Russian Federation and the United Kingdom.

83. During the second three-year phase, which began on 1 June 1994, EE2000 will concentrate on financial engineering for energy efficiency projects in economies in transition and energy efficiency labels and standards.

84. The technical cooperation programme "Promotion and Development of a Market-based Gas Industry in Economies in Transition" has been successfully launched. The Trust Fund and an interim Advisory Board have been set up, consisting of representatives of organizations supporting the programme. The initial programme includes issues related to privatization and restructuring of the gas industry, gas pricing and management of the gas industry in economies in transition, putting emphasis on training of senior managers. Other activities will include establishing a network of organizations and individuals and a database on institutional and regulatory measures, as well as the investment projects.

85. The Committee on Energy approved the launching of a five year Implementation Programme on Accelerating Clean Coal Technology (IMPACCT) in order to promote access to available technology on a least-cost basis and to facilitate launching of pilot projects in economies in transition. The possibilities of funding support for this programme are being explored.

Industry

86. The programme of work of the subsidiary bodies and the regional advisory services in the field of industry and technology have been modified with a view to assisting the integration of the economies in transition into regional and global markets.

87. Among the projects of special interest to countries in transition, the Senior Advisers on Science and Technology assist the national authorities of the economies in transition in formulating and implementing science and technology policy by undertaking activities aimed at collecting and disseminating statistical data on main science and technology indicators compatible with the OECD methodology. A new programme activity, "Role of science and technology in securing sustainable development in the economies in

transition" was added to the work programme of the Senior Advisers in 1994. A comparative study of chemical legislation in ECE member States has been launched to assist the economies in transition in the formulation of their own legislative programmes. Another study on restructuring and changing ownership in the steel industry will identify trends in the change of ownership in the steel industry in different parts of the world, including the countries in transition. A review of the state-of-the art in robotics with emphasis on the economies in transition will contribute to solving special problems caused by industrial restructuring, changing ownership and unemployment. A training programme on standardization and related activities especially designed for countries in transition has also been launched.

88. The demand for advice and assistance, on both industry-related policy and techno-economic matters, from the countries in transition remains high. In 1994, the Industry and Technology Division has assisted host Governments to prepare and service 7 workshops in 6 different countries, 5 of them in transition, and 5 workshops in countries in transition are planned in 1995. A seminar on product statistics was held at Geneva. It was supported by the European Commission and had broad participation from the economies in transition.

89. A new edition of the Directory of Chemical Producers in Central and Eastern Europe was published recently. The directory assists European and other agencies to identify and establish direct contacts with producer firms in the economies in transition. As a follow-up to activities undertaken in the field of medical engineering, recent developments in clinical engineering will be reviewed. The work will focus on the needs of countries in transition, with emphasis on hospital technology and equipment.

90. The regional advisory services programme, established in late 1994, has been directed at analysing the difficulties of the transition process, reform reviews and the formulation of coherent national policies and strategies for the economies in transition. To date, 13 written requests have been received for assistance in the area of industry and technology, including 7 from central and eastern Europe, 1 from the Baltic States and 5 from the CIS. Technical cooperation and advisory services have also been launched to implement a pilot project demonstrating the environmental clean-up of selected sites polluted by chemicals in the economies in transition.

91. An important issue for the economies in transition is advice on the promotion of SMEs. Assistance on the development of SME infrastructures is currently being offered within the framework of the Working Group on SMEs of the Central European Initiative. The preparation of country studies on SMEs has been started in Bulgaria, Georgia, Belarus and the Former Yugoslav Republic of Macedonia. An umbrella project on the promotion of SMEs in the economies in transition is in the preparation process and financing is being sought.

Agriculture and Timber

92. Several workshops have been held and are planned related to sustainable agriculture and environment, including the setting up of a team of specialists and a roster of existing training centres; quality assurance of meat and meat products, including methods of food standardization and inspection; international harmonization of soil conservation monitoring systems; water

pollution; management of agricultural enterprises; evaluation of forest production including environmental and social benefits of forests; marketing of forest products, effects of global climate change on boreal and temperate forests, forest seed collection and storage, institution building and infrastructure for sustainable development.

93. All workshops pay particular attention to disseminating recommendations and results.

94. In June 1994 a team of specialists reviewed the Timber Committee's programmes for countries in transition in the light of work by other organizations and countries' needs and priorities and identified programme areas for priority activities.

95. ECE/FAO has been appointed international coordinator for the follow up of the resolution on Forestry Assistance to Countries in Transition of the Helsinki Ministerial Conference on the Protection of Forests in Europe. The above-mentioned team designed an enquiry which was circulated in July. An interim inventory of all activities in this area (bilateral and multilateral) is to be submitted to the Helsinki follow-up meeting in Turkey in January 1995 which will decide on future action.

96. Other activities related to assistance to CITs include: preparation of forest and forest products sector country profiles for Albania, Belarus, Bulgaria, Estonia, Lithuania, Slovenia and Ukraine (in addition to four earlier profiles); consideration of the outlook for the sector in the transition countries, including sustainability aspects, in the context of the fifth European timber trends study (ETTS V); team of specialists on problems arising from radiation contamination, particularly the Chernobyl disaster, i.e. two meetings and a workshop to deal with the major forest problem in Belarus and Ukraine, as millions of hectares may no longer be exploited and represent an extreme fire- and public-health hazard as well as a loss of income.

Human Settlements

97. In the field of human settlements workshops have covered such topics as training on cadastre; problems of historical cities in the new context; data processing in cadastre; and land registration and cadastre and housing problems and policies in the transition period, as well as housing in urban management.

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WAYS AND MEANS OF PROMOTING THE EXPANSION OF TRADE IN TRANSITION ECONOMIES

Report by the secretariat

PART I

Executive Summary and Recommendations

Note: With reference to its decision C (49) on promoting the expansion of trade for products from the countries in transition in international markets, the Commission at its forty-ninth session requested the Executive Secretary, in consultation with member States of the ECE, to prepare a study containing recommendations on ways and means of promoting the expansion of trade of the countries in transition.

The secretariat has therefore prepared the following study entitled "Ways and Means of Promoting the Expansion of Trade in Transition Economies" in three parts: part I "Executive Summary and Recommendations" (E/ECE/1311); part II "Diagnosis of the Problem" (E/ECE/1311/Add. 1); and part III "Specific Measures and Conclusions" (E/ECE/1311/Add.2).

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WAYS AND MEANS OF PROMOTING THE EXPANSION OF TRADE IN TRANSITION ECONOMIES

PART I

A. EXECUTIVE SUMMARY

1. Objective of the report

1. The purpose of this report is to analyse the trade-related problems faced by the transition economies and to propose selected, specific measures to develop their trade. It sets out a coordinated, regional action programme for the expansion of trade, to benefit the economies of central and eastern Europe and the Newly Independent States (NIS).

2. General results

2. Because most of the transition economies are relatively small and have limited resources, improving their trade performance is essential for the success of their reform processes. However, the trade performance of the transition economies since 1989 has been disappointing. The contraction of exports has coincided with a shift in the commodity composition towards mainly low value-added products and raw materials.

3. In order to improve this situation and to increase the competitiveness of their exports, Governments in the transition economies have an important role to play in supporting the creation of a favourable environment for their private enterprises. In this respect, macroeconomic stabilization and privatization are two prerequisites and should therefore be the primary objectives of all the Governments in the region.

4. The coordinated regional action programme identifies core sets of priorities for Governments of the Commonwealth of Independent States (CIS), of central and eastern Europe, and of western market economies. Faced with limited resources and with the impossibility of financing all the desirable measures, transition economies should rather concentrate on the issues where improvement is most needed. With a view to helping implement the recommendations of this report, some proposals are made in fields where the UN/ECE, in cooperation with other international agencies, has a significant role to play. These include studies and conferences, special projects, and large-scale trade development programmes.

3. Diagnosis of the problems

5. This report indicates that internal and external barriers hamper the development of trade in the transition economies. Although external barriers (e.g. market access conditions in western economies) should not be overlooked, in most transition economies internal factors (e.g. infrastructure-related problems and management deficiencies) seem to be relatively more important.

6. Although differences exist between the transition economies, there are common internal obstacles to the development of trade and enterprise competitiveness. The most significant are:

a. at the national level:
- payment-related problems
- inadequate infrastructure
- poor channels of information

b. at the enterprise level:
- low productivity
- management- and human resource-related problems
- obsolete plants and equipment
- low quality products and inadequate marketing skills.

7. Regarding market access, there is still scope for conditions to be improved. However, in 1994-1995 the situation of the transition economies has benefited from the following:

(a) the successful conclusion of the Uruguay Round which will have a beneficial, though different, impact on the transition economies, depending on whether or not they are General Agreement on Tariffs and Trade (GATT) members;

(b) the conclusion of preferential trade agreements with both the European Union (EU) and countries of the European Free Trade Association (EFTA), with a growing number of central and east European countries, and the Partnership and Cooperation Agreements between the EU and some countries of the CIS;

(c) the signing of various free trade agreements amongst transition economies (Central European Free Trade Agreement (CEFTA), Baltic Free Trade Agreement, and the CIS Free Trade Area Agreement).

4. Specific measures

8. The specific measures proposed to facilitate trade cover topics like institutional development, international trade standards, foreign direct investment (FDI), and settlement of payments and financing mutual trade:

(a) Institution-building measures focus on the creation of trade facilitation, promotion and development organizations, which provide direct assistance to national exporters and/or help Governments to design appropriate trade policies.

(b) International standards play a vital role in expanding international trade. UN/ECE standards will assist transition economies to improve their trade performance provided information can be disseminated to these economies and to the companies who will use them.

(c) Foreign direct investment should be actively solicited, but only on the right conditions. FDI in the transition economies for the past four years has been disappointing. By the end of the first half of 1994 it was just over US$ 20 billion, with almost half of it going to one country (i.e. Hungary). This report shows that all FDI does not have a positive impact on trade. FDI by small and medium sized enterprises seems to be more export-oriented and trade stimulating than capital invested by very large companies.

(d) Improvements in payments and trade financing are urgently necessary to relieve major obstacles to the development of trading relations for enterprises in transition economies. In the CIS, in particular, the inconvertibility of most national currencies and the absence of a multilateral payment system seriously hampers any trade development programme. Risk is the main source of transaction costs in all transition economies, and special measures should be implemented (supported by international financial agencies) to alleviate this problem.

5. Structure of the document

9. The document comprises three Parts (I, II and III) and is divided in seven Sections (A-G).

10. Part I consists of Sections A and B. Section A is this executive summary and Section B makes recommendations and proposals for a coordinated, regional action programme.

11. Part II sets out the diagnosis of the problems. It is divided in Sections C, D, and E which encompass the introduction (C), an analysis of the importance and structure of the trade of transition economies (D), and a discussion of the main factors affecting the trading competitiveness of transition economies (E).

12. Part III comprises Sections F and G. Section F proposes specific measures to facilitate trade, and Section G presents the main conclusions of the study.

B. RECOMMENDATIONS AND PROPOSALS FOR A COORDINATED REGIONAL ACTION PROGRAMME

1. Introduction

13. The purpose of this section is to present to ECE member Governments an outline for a Regional Action Programme on measures for expanding the trade of transition economies. This programme is based on the preceding analysis found in Sections A-C, and takes account of the assistance which is being provided both multilaterally by other international organizations and bilaterally to transition economies in the trade and trade-related fields.

14. The programme is divided into two parts: Part I describes the chief recommendations to Governments of western market economies and transition economies. Part II identifies specific actions that the Commission might consider adopting as a follow-up to this report.

2. Regional Action Programme to Boost Trade in Transition Economies

Principal Recommendations

(a) Addressed to transition economies:

(i) Prerequisites

15. Adopting measures to boost their trade and export competitiveness will be ineffective unless the transition economies establish an appropriate basic framework for their trade enhancing programme. This framework should consist of two prerequisites:

a. macroeconomic stabilization (Part II, para. 33). 1/ Transition economies should reduce their macroeconomic imbalances, by measures to control inflation and reduce Government spending;

b. the promotion of the private sector (Part II, para. 34). Transition economies should encourage the private sector since it is entrepreneurs, not Governments, that create trade. Broadly speaking, the development of a competitive private sector means the privatization and breaking up of the former State monopolies, the development of small and medium-sized enterprises, the reorganization of the financial sector and the creation of the necessary legal and regulatory framework.

16. The first requirement is necessary for building confidence amongst market operators and encouraging investment. The second, through, in particular, the creation of a strong and viable SME sector, will promote trade expansion and diversification.

17. Already, many of the transition economies have made considerable progress towards macroeconomic stability and the private sector has been growing significantly, although in both areas there still remains a lot to do.

18. In addition, in order to implement their trade development programmes, all transition economies need to develop a set of strategic objectives with regard to their trade sector. These objectives will of course have to take account of the country's particular resource and factor endowments. They will include no doubt political considerations concerning the direction of the country's trade. However as noted in this report, these objectives to varying degrees should set out to:

a. increase the value of exports (Part II, para. 12);

b. either sustain and build on the existing penetration of their exports in western markets or, in the case of the CIS, establish an export presence on these markets (Part II, para. 14);

c. develop intraregional trade (Part II, para. 90);

d. improve the commodity composition of exports (Part II, para. 15).

(ii) Fixing a core set of priorities with limited resources

19. In setting out to achieve these objectives and faced with limited resources the transition economies will not be able to finance all the measures they could or should adopt. They will rather have to identify priorities.

20. For CIS countries the priorities should be:

- improving the payments system and liberalizing trade;
- building trade promoting institutions;
- introduction of modern Customs procedures;
- adopting common standards;

- establishing a commercial framework with emphasis on legal enforcement and the protection of property rights;
- investing in trade facilitation.

21. With regard to payments, priority action by the CIS States and the international community is required (Part III, para. 54). No new payments system has been developed to support the shift from the old centralized trade structure, using techniques to balance trade flows bilaterally though Government arrangements and barter, to multilateral trade conducted autonomously by enterprises. In order to address this problem Governments should improve their regional payments services, support the introduction of a multilateral clearing facility and introduce measures to reduce exchange rate fluctuations amongst CIS currencies.

22. To this end, CIS Governments agreed in October 1994 to establish a Payments Union but considerable problems still remain in implementing the Agreement (Part III, para. 61). In order to implement it, the following measures should be taken:

a. National foreign exchange markets should be strengthened;

b. A blueprint should be elaborated for the establishment of a multilateral clearing facility for regional payments for goods and services in national currencies;

c. facilities for financing regional trade and export insurance cover should be developed based on international experience and with international financial support.

23. Steps to improve trade financing should be accompanied by greater trade liberalization, achieved through:

- standstill and subsequent roll-back of existing restrictions on regional trade;

- phasing out of centralized trade, export quotas and licensing;

- coordinated harmonization of trade and Customs laws in line with multilateral standards (see below);

- development of a CIS secretariat charged with implementing the provisions of the free trade agreement and payments union.

24. Concerning Customs (Part II, para. 52), a modern Customs organization for effective revenue collection, the facilitation of international traffic and the application of controls to guard against illicit traffic and fraud, will be required. This will need:

- new Customs legislation;
- application provisions relating to the Customs code;
- training of Customs officials;
- the creation of suitable modern border posts at major frontiers;
- investment in modern information technology;
- collection of accurate trade statistics.

25. Not only will these measures facilitate international trade, they will improve revenue collection and cut down on fraud, so contributing directly to the public treasury.

26. Governments of the CIS States should commit themselves to develop a coherent system of standards and certification (Part III, para. 6). This is a priority because with the break-up of the Soviet Union (which had uniform standards and certification requirements for all the Soviet Republics), the Newly Independent States have created a separate system of standards and certification, resulting in the creation of artificial barriers which hinder the development of multi-country trade. In creating these common standards, Governments should ensure that they allow for mutual recognition among the CIS and western market economies, and investment in the latest non-destructive testing technology.

27. This will require the establishment of a network of institutions and organizations for standards and certification in the CIS compatible with those existing in western market economies.

28. A proper trade promotion office (TPO) should be created in each country. The central task of the TPO will be to provide helpful information to exporters on foreign markets, market access conditions and standards (Part III, para. 1). ITC in particular could be asked to assist in developing these institutions.

29. TPOs should not be allocated any controlling or licensing functions; they should be purely devoted to serving the business sector. In this capacity it is advisable that close contacts be built between the TPO and the local business community with representatives of trade organizations and chambers of commerce being invited to attend meetings and to participate as members of the Board of Directors.

30. Special measures are required to build export promotion skills, including training programmes for staff and training courses on export promoting skills in universities and business schools. Ideally, they should be partly publicly and partly privately funded, with private revenues coming from enterprises in the form of fees for services rendered. Whenever feasible, the private sector should be involved in planning the training.

31. Establishing an effective national trade facilitation organization (NTFO) in each country should be a priority. The objective of an NTFO is to simplify trade and transport procedures by promoting consultation and cooperation among all participants in international trade from both the public and private sectors. An NTFO provides a forum for dissemination, discussion and national adaptation of UN/ECE standards on trade facilitation. It can further assist in channelling advice and information on these standards to market operators. The importance of establishing an NTFO has led to a specific UN/ECE recommendation on this subject. 2/

32. For the non-CIS countries a different although related set of priorities will be required:

a. strengthening and extending their intraregional free trade associations; the Central European Free Trade Agreement (CEFTA) and the Baltic Free Trade Agreement should be encouraged and extended to include new members. Progress in lowering of barriers to mutual trade should be accelerated (Part II, para. 90);

b. disseminating information on and assisting exporters reach western product, health and safety, technical and environmental standards (Part II, para. 53); Governments must provide their exporters with information on these standards and new specifications and assistance in meeting these;

c. enforcing the newly created commercial frameworks (Part II, para. 40); while a host of new laws have largely completed the legal framework of a market economy in may of these countries, there are problems with implementation and enforcement of laws, contracts, etc. Indeed, the institutions that are necessary to support this framework, civil law lawyers, judges and the registration institutions for lands and property rights are either undeveloped or absent;

d. simplifying Customs procedures (Part II, para. 52); transition economies should streamline Customs and trade procedures in order to bring them into line with best western practices. Unlike in the CIS, developed procedures do exist but they utilize few modern techniques and lack the latest information technologies. UNCTAD's programme for streamlining of trade and Customs procedures, Customs computerization, trade information and the establishment of trade points offers interested economies in transition excellent support;

e. developing export financing facilities (Part III, para. 65); export financing for pre-shipments, short to medium-term credit and for certain products is difficult to obtain in these transition economies. As noted, the problem is not a lack of resources but often the weak institutional framework. Banking institutions are underdeveloped. Country risk is high and possibilities for assessing and mitigating risk are limited. Governments should develop these institutions and seek assistance in financing them from western donors. Specifically, export-import banks might be set up. Training bankers in export financing techniques should also be a priority. The EBRD has substantial programmes to improve local banks' ability to provide finance by increasing the confidence of foreign correspondent banks in dealing with them; by providing re-financing facilities for export and pre-export finance; and in assisting the banks in managing foreign exchange risk.

f. establishing export credit guarantee facilities. Transition economies should develop the full set of guarantee instruments available to western firms. Deficient insurance systems increase the transaction costs in trade finance which negatively affects bank-client relationships and intraregional trade in particular. Some transition economies have established Export Credit Guarantee Facilities but these tend to suffer from a lack of finance. Direct technical assistance to local export credit agencies has been extended to the Czech and Slovak republics. More generally, assistance is given to six agencies via the Secretary General of the Berne Union with support from the EBRD.

g. encouraging FDI from western SMES to boost intraregional trade. FDI from western small and medium-sized companies should be targeted. SMEs can have greater pro-trade effects than larger companies. Because of their size they tend to be more attracted to locations with low factor cost advantages and where they can benefit from such lower costs to establish export-oriented production. Larger firms have entered eastern Europe predominantly to sell goods and services to the domestic market. Some of the large-scale investors have moreover influenced Governments to protect their newly acquired local markets, a policy which, if used extensively, can have a negative effect on exports (Part III, para.38). SMEs, although they do not bring with them as much investment capital as larger foreign companies, can have better trade effects over the longer term. Thus, encouraging investment promotion from this sector will increase the pro trade effects from FDI.

h. promoting new forms of financing trade. To overcome the financial problems faced by these smaller western companies Governments should also look at alternative arrangements which can have significant trade effects, notably subcontracting and leasing. In addition, Governments should encourage asset-based financing techniques where western companies are paid for importing equipment, machinery and management skills and quality standards from the production which is exported to western markets.

i. encouraging FDI in technology intensive industries. Governments should also use FDI to upgrade the technological capabilities of their countries by providing assistance to foreign firms to set up R & D operations and to create linkages between these firms and local enterprises.

j. improving the provision of services to exporters. TPOs should commission studies of products and markets with export potential (see study undertaken for Portugal, Part II, Box 1) in order to determine whether they are providing such sectors with the best services. These studies are important for making TPOs more efficient and in ensuring that scarce resources are used to their greatest effect. The International Trade Centre (ITC) has valuable expertise to offer.

(iii) Second phase measures

33. Having dealt with, or set about remedying, the core deficiencies in their programmes to expand trade and export competitiveness, the transition economies should promote, with the help of international assistance, a series of enterprise support projects at the micro-level. These should include:

a. **measures to build-up the response of the enterprise sector to the new trading opportunities** As the new trade rules and the liberalization following the GATT agreement are put into effect, Governments should develop support projects to inform their traders of the new opportunities and what they should do in terms of improving packaging, marketing, quality control and supply of components. The ITC has projects in these areas and could provide assistance.

b. **organization of a partenariat for SMEs** In view of the need to restore the commercial and economic ties that broke down following the collapse of the former trading system, Governments should promote economic cooperation between SMEs in order to develop multi-country trade. The PHARE programme could assist with providing information on how such schemes have been working in western Europe and in Poland.

c. improving the **negotiating skills of exporters of commodities** from transition economies. The dependency of many transition economies on commodities for the bulk of their export revenues means that Governments should ensure that their companies have adequate training and information on prices in concluding deals and marketing arrangements with large western sellers of commodities. UNCTAD provides training in specialized commodity trading.

d. **increasing the channels for western technical assistance into firms**. The best means of assisting enterprises to develop trading opportunities is to have western business experts work in the plants on a short-term basis as advisers, helping with finding suppliers and finance from the west for trade. The TACIS funded European Senior Services Consortium (ESSC) aims to tap the vast wealth of experience of over 20,000 western European business experts. This is an innovative means of providing excellent advice to enterprises with no experience of trade. It can therefore have an immediate and direct beneficial impact on exports. Transition economies should therefore encourage this form of assistance.

e. **developing and modernizing commercial road haulage**. Much of the trade will go by road and Governments should assist this sector to modernize, encouraging privatization, the break-up of monopolies and the developing of partnerships with western road transport companies.

(iv) Upgrading trading infrastructures

34. Feeding into these core areas and second stage projects, transition economies will have to adopt the necessary measures to upgrade the infrastructures vital for their trade. Exporters cannot export without an adequate communications network, a transport system that ensures speedy and reliable delivery of products to key markets and a source of energy supply that is secure (Part II, para. 39).

35. None of the basic infrastructure works adequately in transition economies.

36. Finance represents the key constraint as upgrading will require substantial amounts of capital. Multilateral lending agencies, notably the EBRD and the World Bank, are assisted in this task but their contributions will not be able to match the requirements. Governments should therefore explore new methods of financing the development of these necessary infrastructures. In particular they should consider broadening the financial

base of these services - telecommunications, transport, energy, etc. - to private sector companies.

(b) Addressed to western market economies:

37. The principal way that western market economies can assist transition economies in boosting their trade is to remove all remaining trade barriers. Tariff-free access to western market economies will help to end the uncertainty over market access and build confidence amongst traders and foreign investors.

38. Agreements recently concluded with the Baltic Republics should be extended to those CIS States which have shown their commitment by introducing market economy reforms. Talks on free trade agreements with some CIS States scheduled for 1998 should also be brought forward (Part II, para. 76).

39. The conditions contained in the existing preferential agreements should be improved (Part II, para. 89):

- the EU should signal its willingness to extend free trade to agricultural goods, as foreseen in the Europe Agreements. A pre-condition of such a move would be the restructuring of the Common Agricultural Policy of the European Union, which has already begun in the context of the Uruguay Round.

- the rules of origin should be improved through the easing of local content requirements (Part II, para. 87).

- progress towards more simplified and transparent procedures regarding anti-dumping should be made (Part II, para. 83). Non-European industrialized countries can also remove obstacles to the expansion of the trade of transition economies, e.g. the USA could simplify its anti-dumping procedures. Provided the relative prices of their products reflect the real costs of production, western economies should use the normal calculation procedures of determining price and not the ones applied to State-trading economies (Part II, para. 83).

- the EU, within the framework of the Europe Agreements, should apply the doctrine of exhaustion (Part II, para. 88).

40. Other subsidiary but nevertheless very important ways in which western market economies through large-scale programmes of technical assistance can assist transition economies will include:

- help in building trade promoting institutions in transition economies;

- encourage the development of standards and the fullest possible participation in international standards organizations;

- provide transition economies with timely information on new standards and conditions, especially relating to health and environment;

- encourage flows of export-oriented FDI;

- assist in the creation of trade financing institutions, for example, export-import banks in transition economies;

- support the creation of efficient Customs operations and the adapting of Customs legislation to the requirements of market economies.

41. Many, if not all of these activities are already covered by existing Technical Assistance programmes. However, the number of countries now requiring such help has increased and the resources and programmes devoted to this work must be correspondingly enlarged.

3. Specific measures

42. The following proposals are intended to assist in implementing some of the main recommendations in this report. They are divided into (i) studies/conferences to explore some of the issues raised in more depth and to undertake follow-up studies, (ii) special projects to be undertaken by UN/ECE's Principal Subsidiary Bodies and working parties, in conjunction with other organizations providing technical assistance in the trade area; and (iii) large-scale trade development programmes that will require special funding. Where appropriate, it is suggested that these proposals are carried out with, or for, other international agencies providing technical assistance to transition economies in the trade area.

(i) Studies/conferences:

- a report on the technical assistance which is being provided to boost trade and strengthen the export capabilities of transition economies, identifying gaps, duplication and possible synergies and priorities;

- a conference involving the OECD and the TCMD Division (responsible for Transnational Corporations) of UNCTAD, to examine the use of trade related incentive measures in attracting FDI as a possible barrier to trade in transition economies in order to shed light on this practice and to make recommendations;

- an examination of successes and failures of industrial policies adopted by central European countries to boost enterprise competitiveness;

- a study on raising the competitiveness of east European agriculture, steel and textiles;

- workshops on the importance of investment in trade related technologies.

(ii) Special projects:

- meeting by the UN/ECE of Trade Ministries in transition economies to discuss common problems and strategies for renewal of trade policies (to be organized under the auspices of the Committee on the Development of Trade);

- organization of a pilot investment promotion seminar for the SME sector in a CIS country;

- development of a Guide or training manual on trade financing techniques and practices for bankers in transition economies (This Guide could be prepared under the auspices of the Working Party on International Contract Practices in Industry (WP.5);

- a conference on the importance of UN/ECE standards - in industry, agriculture, environment, UN/EDIFACT, etc. - and their practical utility in boosting trade. The purpose of this project will be to encourage representatives of transition economies to participate in international and regional standard setting activities and to understand their importance for building their export capabilities;

- a project to simplify Customs procedures in transition economies in cooperation with the World Customs Organization;

- a project to help transition economies in assessing the suitability of the legal environment for trade and investment, undertaken by the UN/ECE group of legal experts, constituted in the Working Party on International Contract Practices in Industry (WP.5).

(iii) Large-scale trade development programmes

- assistance to Governments in the design of their trade policies (in cooperation with UNCTAD, ITC and UNIDO);

- projects to assist transition economies in trade promotion by:
    - establishing trade promotion offices;
    - increasing the effectiveness of Customs departments and chambers of commerce;
    - providing training and counselling to standards institutions.

- projects to assist the trade of small transition economies by:
    - assisting primary and commodity producers to increase their export earnings;
    - developing new tourism projects;
    - increasing competitiveness of existing exports and finding new markets;
    - providing technical assistance in new information technologies.

Notes

1/ The reader is referred to the corresponding section of the report for further details.

2/ Recommendation No. 4, "National Trade Facilitation Organs", Working Party on Facilitation of International Trade Procedures (WP.4).

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Report by the secretariat

ADDENDUM 1

PART II

Diagnosis of the Problems

Note: With reference to its decision C (49) on promoting the expansion of trade for products from the countries in transition in international markets, the Commission at its forty-ninth session requested the Executive Secretary, in consultation with member States of the ECE, to prepare a study containing recommendations on ways and means of promoting the expansion of trade of the countries in transition.

The secretariat has therefore prepared the following study entitled "Ways and Means of Promoting the Expansion of Trade in Transition Economies" in three parts: part I "Executive Summary and Recommendations" (E/ECE/1311); part II "Diagnosis of the Problem" (E/ECE/1311/Add. 1); and part III "Specific Measures and Conclusions" (E/ECE/1311/Add.2).

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1. Institutional measures

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G. CONCLUSIONS

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WAYS AND MEANS OF PROMOTING THE EXPANSION OF TRADE IN TRANSITION ECONOMIES

PART II

C. INTRODUCTION

1. This report has three objectives: to examine the general problems confronting the transition economies in developing their trade, to identify specific measures which can be used to boost trade performance, and to present a regional action programme of recommendations addressed to transition and western market economies which can help stimulate the expansion of trade.

2. Few disagree on the need for transition economies to expand their trade. The transition process to a market economy in countries in central and eastern Europe has exerted a negative effect on production, GDP and, in many countries, on foreign trade. Trade is vital for the success of the transition to market economies. Increasing exports will raise the necessary revenues to import the capital goods which are required to restructure their enterprises. Increased trade moreover will integrate the transition economies into regional and world markets. It will also boost the competitiveness of domestic firms and allow for growth in economies still suffering from reduced domestic demand. In the short- to medium-term, as the barriers to the import of goods and services fall in transition economies and competition in their domestic markets intensifies, the need to increase their exports will grow even stronger.

3. While in general there is agreement on the need for transition economies to increase their trade and expand their exports, there is less consensus on the causes and on the solutions to the transition economies' trade problems. In examining causes of the transition economies' trade problems, for example, there is a wide debate as to the relative importance between external trade barriers (i.e. tariff and non-tariff barriers erected by western market economies, against eastern imports) and the internal barriers (i.e. the poor competitiveness of domestic firms and lack of adequate infrastructures and institutional support) in accounting for trading deficiencies. In addition, some see trade financing problems as due to a chronic shortage of capital in the region while others see the causes lying with the poor domestic financial institutional structures. On the measures and strategies to adopt to improve trading conditions, further debate is generated over the role of Governments in expanding trade, and the degree to which market failure and infant industry arguments can justify more protectionist and interventionist strategies. Additionally, the desirability of attracting foreign direct investment to expand trade has become a matter of considerable contention in several transition economies.

4. The answers to these and other questions which are discussed in this report are highly relevant in building strategies to develop trade in the region. The transition economies need to evaluate the importance of these factors in order to make their trade polices more effective and more efficient. With limited resources, together with the vast range of measures they are confronted with, they will be compelled to choose between those measures that are needed immediately and those that can wait until certain of the other measures have been implemented. Western Governments, too, must assess the importance of these factors influencing trade, not only because

they directly benefit from the enhanced trade performance of the transition economies, but because they want to be assured that their technical assistance policies are being properly targeted to those areas where it will have best effect. For example, should their technical assistance (on legislative and financing advice) which has laid the groundwork for numerous privatizations involving western companies be now considered appropriate when one of the effects of such investments has been the raising of import tariffs by Governments to protect newly acquired companies and to deter new investment?

5. It should be clear that the differences amongst transition economies, as well as the different stages at which they find themselves in the process of transition, makes the task of presenting a set of recommendations for all transition economies an extremely daunting one. In the trade field, for example, most of the CIS States are in the early stages of nation and institution building while the economies of central Europe already have well established institutions even if they are not completely structured for market economies. Clearly, CIS States will have sets of priorities that will differ from the central European countries. Nevertheless the transition process is itself still a sufficiently strong common factor and the goals of trade and export competitiveness sufficiently universal to justify the attempt to cover the transition economies as a group.

6. This report, however, given the scale of the topic and the relatively limited time frame, cannot cover all the issues affecting trade. It has thus tried to be selective focusing on those areas where the UN/ECE can make a particular contribution either through its own activities or in cooperation and support of other international agencies and made suggestions for carrying on with this work (see Part I, Section B, Recommendations). Governments of ECE member States are encouraged to examine these proposals and invited to make their own suggestions for follow-up work in an area which is bound to increase in importance as the processes of economic integration grow stronger in the region.

7. The report is divided into three Parts: part I, sections A and B, provides the Executive Summary and Recommendations of the report; part II, sections C, D and E presents the introduction of the report and a diagnosis of the main problems affecting the trade of transition economies. Part III, sections F and G describes the specific measures to facilitate trade and the conclusions of the report.

DIAGNOSIS OF THE PROBLEMS

D. IMPORTANCE AND STRUCTURE OF THE TRADE OF TRANSITION ECONOMIES

8. For the transition economies of east Europe and the former Soviet Union foreign trade has been an important factor of economic growth and the key determinant of their external balance. Except for Russia, all transition economies are relatively small economies with limited resources, and their reliance on trade has been increasing ever since they broke away from a policy of economic autarky in the late 1950s. Under the socialist regime, the countries of central and east Europe tried to develop intra-group integration, but those efforts failed because of the systemic deficiencies of central planning which led to massive misallocation and wastage of resources. The significance of foreign trade further increased after the countries in the

region decided to open their economies to international markets in the wake of comprehensive market-oriented reforms initiated in the late 1980s and the beginning of the 1990s.

9. However, the overall trade performance of the countries of east Europe and the former Soviet Union since the beginning of the transition process has been generally disappointing, with aggregate trade levels falling or at best stagnating. The dollar value of exports in 1993 was in most countries lower than in 1988, sometimes by large margins. Imports generally fell less, and in some countries even increased quite substantially, raising problems in the balance of payments. The asymmetric development of exports and imports resulted in a substantial deterioration of the trade balances of the transition economies between 1988 and 1993 (see table 1), and only in 1994 have some signs of an improvement begun to emerge.

Table 1
Foreign trade of transition economies,
1988-1993, million US$

Country group	1988	1989	1990	1991	1992	1993
East Europe[*/]						
exports	53,478	51,052	48,551	43,471	44,886	45,057
imports	48,031	46,735	45,697	45,636	52,066	56,837
trade balance	5,447	4,317	2,854	- 2,165	- 7,180	- 11,980
Russian Federation						
exports	..	74,735	71,148	50,911	42,391	44,297
imports	..	77,932	81,751	44,473	36.990	26,807
trade balance	..	- 3,197	- 10,603	6,438	5,401	17,490

[*/] Bulgaria, Hungary, Poland, Romania, the Czech Republic and Slovakia (Czechoslovakia until 1992).

Note: Rouble trade flows in 1988-1991 for east Europe converted into dollars at a "consistent" cross exchange rate (see: UN/ECE Economic Bulletin for Europe, Vol.43/91).

Source: UN/ECE data base and national statistics.

10. The foreign trade performance of the central and east European countries (CEECs) in the first half of 1994 was marked by an expansion of trade flows and improvement of trade balances. The expansion signals the first reversal in the contraction of exports observed in the region since 1989, and a marked improvement over the first half of 1993 when exports fell by more than 4 per cent. For the same period, the overall value of imports into the region declined by nearly 5 per cent, again marking a reversal of the expansion observed in 1992 and 1993. If export growth was chiefly driven by a revival of western demand, the slow-down of imports has been mostly a policy-induced phenomenon which resulted from varying combinations of restrictive monetary policies, protectionist measures, shifts in trade regimes (gradual elimination

of barter transactions) and, in some cases, depreciation of domestic currencies.

11. A comprehensive assessment of trade developments in the region is not an easy task, chiefly because all the statistical measures of changes in the composition and levels of east European trade are subject to varying but substantial degrees of imprecision.1/ Nevertheless, three major tendencies, common to nearly all the transition economies, can be identified for the period 1988-1993. These are: the overall fall of exports, the reorientation of trade from east to west, and the shift in exports towards natural-resource-based and relatively less processed goods.

12. The contraction of exports was mainly caused by the collapse of the Council for Mutual Economic Assistance (CMEA) trading system which involved the abandonment of artificially low rouble prices and a shift to decentralized trade among the eastern countries. The parallel expansion of exports to western markets, made possible by the general liberalization of foreign trade regimes in most transition economies, has not been sufficient to compensate for the fall of intra-regional trade. On the basis of an assumed set of consistent exchange rates,2/ the overall value of exports of six east European countries diminished from US$ 53.5 billion in 1988 to US$ 45 billion in 1993, while the value of exports of the Russian Federation dropped from US$ 74.7 billion to US$ 44.3 billion. In the same period, the combined trade balance of east European countries shifted from a surplus of US$ 5.4 billion to a deficit of US$ 12.0 billion.

13. Despite the fall of export levels, the proportion of exports to GDP remained relatively high in the transition economies because of the contraction of output. The ratio of exports to GDP varied in 1993 from 17-20 per cent in Poland and Romania, to 32-34 per cent in Bulgaria and the Czech Republic, with ratios of imports to GDP being generally higher. The relative dependence on trade is lower in Russia and some other larger CIS countries. It is important to note that most of the fast-growing Pacific Rim economies exhibit a much higher ratio of exports to GDP than these countries have done to date.

14. The fall of total export levels masks an important change in the territorial structure of east European exports: the share of the former CMEA partners in total exports declined from between 40 to 60 per cent in 1988 to between 15 and 30 per cent in 1993. Similar changes occurred on the import side. At the same time, the share of western countries increased sharply, with the European Union accounting now for between 50 and 75 per cent of total exports of the transition economies. Russia has been replaced by Germany as the most important single trading partner in the region.

15. The dissolution of CMEA, the collapse of the former Soviet market, and the overall liberalization of trade and payments in east Europe have all resulted in substantial shifts in the commodity composition of east European trade. Most adversely affected have been exports and imports of capital goods, including engineering products, metallurgy and heavy chemicals. Meanwhile, the share in total exports of raw and semi-processed materials and textiles increased sharply, as did the share of consumer goods in imports.

16. A good part of these developments has essentially been a result of the removal of administrative constraints on trade characteristic of central

planning, and as such should be regarded as efficiency-improving. Politically motivated and economically unjustified trade flows have been discontinued and new markets have been found, mostly in western Europe. However, there are also grounds for believing that in some respects the adjustments may have gone too far, and that many potentially viable trade links have probably been destroyed because of the sudden collapse of existing institutional arrangements, lack of necessary finance, abrupt changes in the external environment, and the large increase in uncertainty. The switch from former CMEA markets to new areas of trade expansion, mostly in western countries, is a difficult and time-consuming process, which requires managerial and marketing experience, as well as substantial investment in physical assets and skills; but neither is readily available in transition economies. The precipitate dismantling of CMEA left intra-regional trade in disarray, and the lack of trading arrangements suitable for a market environment contributed to increased risks and high transaction costs, and depressed mutual trade well below economically justified levels. Also, the transition economies seem to have been losing rapidly the export potential which they had accumulated in the past in the engineering and high-technology sectors.

17. If these observations are correct, they may suggest that a purely liberal approach to restructuring is excessively costly in social terms, and may result in the creation of "second class" economies in Europe. "Market-friendly" policies can perhaps be used to a larger extent to order to support activities which have the potential to adjust successfully to market conditions. Historical experience with conventional industrial and trade policies has been disappointing in many cases, and the welfare losses from discretionary and politically-motivated intervention may have been substantial. To be effective, these policies must be innovative, transparent (rule-based rather than discretionary), temporary (gradually phased-out, according to a pre-determined time schedule) and credible. The design and implementation of these "market-friendly" policies is a major task and challenge for the transition economies at the current stage of market transformation.

E. MAIN FACTORS AFFECTING THE TRADING COMPETITIVENESS OF THE TRANSITION ECONOMIES

1. Competitiveness: The Role of Industrial Strategy and Support

18. Successful trading countries are ones which have competitive economies. This is why in looking at ways and means of expanding trade in transition economies, it is worthwhile to examine the meaning of competitiveness and the measures which are necessary to promote it.

19. Competitiveness is not an easy concept to define. The OECD defines competitiveness for a nation as "the degree to which it can under free and fair market conditions, produce goods and services which meet the test of international markets, while simultaneously maintaining and expanding the real incomes of its people over the long term." The OECD definition, although rather general, does underline the importance of trade to overall "competitiveness". However, it is not just trade which makes an economy competitive. Trade is determined by other factors, notably the level of its domestic productivity which is in turn determined by the rate of investment in plants and equipment, R & D, education and training, etc. Strong investment

itself requires a modern financial system and a competitive enterprise sector. Accordingly, expanding trade requires attention to factors which go beyond the trade area.

20. All countries, not just those in central and east Europe, recognize the importance of competitiveness and the need to improve it.3/ In the United States concern at large trade deficits and the loss of many high paying jobs to foreign competitors fuelled discussion about a general loss in competitiveness, focusing attention on wider issues such as education and training, innovation and investment. The European Commission has published a recent White Paper on the topic with the same broad remit.4/ Germany and the United Kingdom have issued separate reports.5/ National Centres of Competitiveness are being established in countries as diverse as the United States, Canada, South Korea, Portugal and Venezuela.

(i) Measuring competitiveness

21. Governments have legitimate purposes in desiring to measure their competitiveness. They wish to know how well they are succeeding against their competitors. They also wish to ascertain where their comparative advantages lie and where they will lie in the future in order *inter alia* to provide special assistance to the sector or sectors so defined (see Box 1), to fill gaps in appropriate institutional and infrastructural support for those sectors or to avoid making inappropriate investments in sectors where they thought they had a comparative advantage but which in fact they did not.

22. Overall competitive scorecards are useful indicators of a country's progress but of less value to the policy maker seeking sector- and branch-specific information. One should note, however, that the *World Competitiveness Report* of 1994 includes three transition economies for the first time in its annual survey. This report evaluates competitiveness according to eight different factors which themselves describe not only the viability of an enterprise but also its competitive environment: domestic economic strength; infrastructure; internationalization; management; government; science and technology; finance; and people. In the 41 countries listed in the World Competitiveness Scoreboard of 1994, Poland was placed last, Hungary 39th and the Czech Republic 36th. The three transition economies which are included in the survey are amongst the six least-competitive countries and are placed behind such countries as India, Colombia and Indonesia.

23. Most models of international trade explain the commodity composition of trade in terms of the law of comparative advantage: countries tend to export those goods which have the lowest relative costs (and therefore prices) under autarky. Direct measurement of past trade performance, or its "revealed" comparative advantage (RCA) can be used, with some reservations, to explain differences in competitiveness and trade.6/ However, in the case of the transition economies, any revealed advantage is bound to be strongly affected by distorted relative prices and the production structures of the former central planning era. Moreover, in many transition economies the trade and industrial data are not available for such measurements.

BOX 1
PORTUGAL'S COMPARATIVE ADVANTAGES

The Portuguese Ministry of Industry, together with 47 of the country's major private and public companies, hired the Monitor Company, a consulting firm headed by Harvard economist Michael Porter, to conduct a study of Portugal's comparative advantages. The intent was to identify those sectors of the economy that would be most competitive for Portugal in the short to medium term.

The study's first phase identified three main areas: agriculture, industry and tourism. Within these areas, Monitor identified for further review six entrepreneurial clusters: tourism, wine, footwear, textiles and clothing, timber products and automobiles. In the second phase, the study will specify actions to modernize the six clusters.

Reactions to the study's first phase were controversial, as some of the sponsoring companies were expecting that the results of the study would recommend the need for the country to concentrate on high tech and innovative technologies. Monitor's six clusters are all part of "traditional" industries. Porter's response was that all industries can be "high tech", and that the focus should be on upgrading them with the most modern equipment and production techniques.

Source: Export Today, p.38, "Why Portugal?", July/August 1994.

24. Recent empirical studies on central European countries based on more data on factor endowments confirm the general perception that transition economies may be most competitive in unskilled and semi-skilled labour-intensive products.7/ One study - which compares unit values and inputs for the same product category - to examine competitiveness in the trade between Germany and central European countries, reveals that all the transition economies, except Hungary, specialize in low quality goods (and import high quality German goods). Hungary is the only country which has been able to establish a relatively strong position in exports of more sophisticated products. Surprisingly, the Czech Republic reveals an insignificant level of "high quality" exports.8/

25. Other methods have been used to reveal competitiveness in transition economies. For example, one study using data on patents registered in the US for western firms which are attributable to technological activity carried out in east Europe between 1969-1990, has sought to identify local technologies in transition economies with a potential for growth and trade. This data reveals a concentration in research in the region associated with chemicals and machinery. Western chemical and pharmaceutical producers have developed certain categories of chemicals in central and east Europe, while metal production and mechanical engineering companies have created machine technologies.9/ This suggests, perhaps unsurprisingly, that in the former Comecon countries there is presently scope for development in some of the more standard technological fields.

26. These and other data on competitiveness in transition economies can only be used as approximations of general trends. They do not provide policy makers with objective indicators of which sectors or branches to promote and which not to promote.

(ii) Measures to boost competitiveness: role of industrial strategy and support

27. At the outset of reforms, Governments in the transition economies were recommended to liberalize their foreign trade sector speedily and in a comprehensive manner. As indicated above, the effects of the rapid liberalization in trade put pressure on these countries' trade balances and in some cases induced a shift in trade to low valued products. The question this raises is whether a more interventionist trade policy, including selective import protection, is now desirable in order to promote competitiveness and reverse some of the undesirable consequences of what, from hindsight, may appear to have been a too rapid liberalization.

28. It is very difficult to build an economic justification for intervention by transition economies in specific industries as part of strategies to boost trade and competitiveness. This is for the simple reason that such policies would not achieve their desired ends.10/ Much had been made of the success in the past of Asian countries and the selection by Government officials of a number of neo-infant industries for import protection. Today, however, research shows that in many relatively fragmented industries where entry barriers are low and there are numerous firms worldwide, it is exceedingly difficult for a single Government through subsidies, import protection or some other form of intervention to alter the international structure of trade or competition, or durably influence its own country's international trade performance.11/ In economic terms import protection acts as a relative disincentive to produce for export markets. The direct manifestation of the cost of this anti-export bias is resource misallocation (higher resource costs associated with production distortions) and higher prices to consumers (consumption distortions). In the reality of central and east Europe, discriminatory protection can send the wrong signals to interest groups, thus creating a momentum for more protectionism while policy makers, as said above, face innumerable difficulties in actually defining where their countries' comparative advantages lie.

29. However, one should not dismiss policies of discretionary import protection for other reasons. Given the technology and productivity gap existing between western and eastern enterprises, rapid liberalization has the potential for sweeping away many non-competitive industries. Protection of so-called "senile industries" can therefore be justified on the grounds of mitigating the adjustment and social costs of liberalization. A gradual phasing out of protection over say a five-to-seven year period is thus preferable. Less justifiable is the protection accorded to some foreign investors, particularly in high technology industries. In some cases, in return for investment and a commitment to jobs, foreign investors have been guaranteed exclusive purchasing deals with the State authorities. Imports of goods covered in the agreement have been restricted. While limiting imports may encourage western firms to invest, and may permit a modicum of employment to be retained over a few years, such agreements put impossible strains on Government officials, e.g. in ensuring that the technology has been transferred to the right specifications and on the agreed time schedule.

These agreements also provide no guarantee that a competitive industrial capability will remain once the agreement has come to an end.

30. For these reasons the use of selective industrial strategies to boost competitiveness should not be seen as a panacea to the poor competitiveness of transition economies.

31. Governments, however, do have significant roles to play if not through industry strategies but with policies of industrial support at the national level. As a general principle, it is enterprises which create wealth, not Governments, and the primary responsibility for improving competitiveness must lie with firms. The Government's role will be thus to create an environment conducive to facilitating private enterprise transactions.

32. A detailed description of the full gamut of policies which transition economies might adopt for this purpose lies outside the scope of this report. However, it is necessary to mention some general features.

33. The Governments' primary objective should be to promote sustained economic growth and higher living standards by ensuring that markets work properly and establishing a stable macroeconomic environment for business. A successful macroeconomic policy is central to competitiveness. Businesses require stability in order to plan investment strategies and to develop products and services. Rapid changes in policies are inimical to this objective; firms will be more willing to invest if they can be reasonably confident of sustained and steady growth in demand. Controlling inflation is also an important objective because of the way it distorts prices and pushes up interest rates. In transition as well as in developed market economies, high inflation encourages an emphasis on short-term profit at the expense of long-term returns. Equally a commitment to sound public finances is required, as without it the uncertainties and costs businesses face rise. High levels of Government borrowing increase the burden of public debt, raise interest rates and ultimately force higher taxation rates or cuts in public spending.

34. Such macroeconomic objectives, if successful, create the framework in which the private sector can develop. Privatization continues to be a key policy objective for transition economies. Already the growth in private sectors is bearing fruit in many of the countries in transition bold enough to have instigated comprehensive privatization programmes. The privatization of distribution networks, in particular, increases options for traders and consumers alike.

35. In their monetary and exchange rate policies, Governments should make capital inflows and outflows as free as is possible with a commitment in the medium term to full convertibility of currency transactions for both current and capital account purposes. This latter objective of course was only achieved by OECD countries after many decades. At present there is free convertibility for current account purposes only (with some restrictions on transactions by non-residents) which means in some countries exporters having to convert all their proceeds into the domestic currency at unfavourable official exchange rates.

36. Governments, operating under the principle of fair and open markets, can help their firms compete more effectively in international markets through an open trade policy, export promotion, cutting subsidies and State aids and

improving conditions for inward as well as for outward investment. Governments should also work to ensure market access for their firms and secure for them advanced and competitively priced inputs for their production processes by committing themselves to reducing trade barriers.

37. The rules and procedures of the new trading system set up under the WTO should be adopted as they will provide much needed stability for market operators in transition economies.

38. Export promotion skills should be developed in transition economies with Governments playing a key role in providing information, advice and support for exporters, drawing on the resources of their overseas offices and an expanding supply network at home. Governments can help exporters further by providing facilities for Export Credit Guarantees. In this regard foreign assistance will be necessary for financing these facilities.

39. Improvement in the institutional environment in which enterprises can boost their competitiveness is also vital. Finance for businesses to grow and to trade should be the top priority of transition economies. Governments amongst other things must, through reform of the financial sector, encourage the supply of long-term finance, the supply of capital to small and medium-sized enterprises (SMEs) and the availability of trade finance. Telecommunications modernization is essential, as is a good transport network. The EBRD and the World Bank, amongst other multilateral lending agencies, have targeted these sectors for support but further investment through different forms of financing (e.g. build, operate and transfer) will be necessary.

40. Businesses, their customers and their suppliers all depend on a clear and effective body of law and regulation. This basic commercial framework includes: competition; company law; commercial law; bankruptcy law; standards; environmental regulation; and intellectual property law.

41. The commercial framework can stimulate private sector development, competition and innovation, and encourage enterprise. But if the framework is weak it will act as a constraint and inhibit commerce. Some businesses may go elsewhere. The commercial framework must be:

- stable - so that it removes uncertainty to businesses:
- enforced - so that businesses are not penalized by the non-fulfilment of contracts or the failure to honour debts;
- lean - so it imposes no more burdens than are essential;
- clear - so that business knows what it can and cannot do;
- applied consistently - so businesses can plan ahead; and,
- business oriented - so that as far as possible businesses are free to make commercial decisions without distortions caused by tax or regulation.

42. Innovation is essential for competitiveness. Countries need companies which innovate. Successful innovation requires good management, appropriate finance, skills and a supportive overall climate.

43. Finally, human resources are crucial for a competitive economy. Transition economies need to improve the skill base of their economies. In particular, a programme to develop management skills in marketing and trade is needed, establishing closer links between employers and educational establishments in transition economies.

2. Macroeconomic stabilization and structural reforms

44. The international competitiveness of the transition economies in the first stage of their market transformation has been affected by a large number of external and internal factors. On the domestic side, the macroeconomic stabilization programmes, as well as a wide range of institutional and structural reforms initiated at the outset of the transition, have been the most important influences on the short-run competitiveness of domestic producers relative to foreign suppliers.

45. Most of the stabilization packages applied in east Europe in the early 1990s comprised several components common to nearly all countries, such as: a) restrictive monetary policies, including high real positive interest rates and contraction of the volume of credit, b) sharp devaluation of domestic currencies, c) liberalization of most domestic prices, and d) a contraction of aggregate domestic demand through direct cuts in government expenditure and falls in private consumption and investment induced by falls in real income and wealth and by high interest rates. All these measures strongly affected trade competitiveness, although their individual impact on exports and imports varied.

46. Factors b) and d) clearly worked in favour of exports, through a combination of positive (increased profitability of exports sales relative to domestic sales) and negative (fall in the real domestic demand) influences. By contrast, factors a) and c) might have been expected to affect exports adversely, because of the reduced availability of export (and production) financing and higher prices for domestic sales. However, because the initial devaluations were typically excessive while a limited number of price controls remained in force, the impact of stabilization policies on exports were probably strongly positive overall. This has been confirmed by the rapid expansion of exports from transition economies to western markets in the immediate aftermath of transformation. On the import side, the devaluations, restrictive monetary policies and the contraction of domestic demand have all had a clearly negative impact on the volume of imports (via decreased profitability of import purchases and lower effective demand for imported goods), although domestic price liberalization has worked generally in favour of imports.

47. The trade of the transition economies has also been boosted by important institutional and structural reforms. First of all, liberalization of foreign trade and payments, including the introduction of convertibility of domestic currencies, allowed many new economic agents and new products to enter foreign transactions, a development which permitted the exploitation of the ample possibilities for price arbitrage through international trade. The institutional opening towards foreign markets resulted in an across-the-board expansion of exports from the transition economies. The internal liberalization of business activities has allowed domestic agents to choose freely the best outlets and sources of supply, a pre-condition for a new, more optimal pattern of trade, based on comparative advantage. Other reforms,

including the improved access for foreign direct investment (FDI) and the creation of capital markets, have also strengthened the incentives and the capacity to export.

48. However, the pro-trade impulses provided by the stabilization programmes are generally of a one-off character, and their effects on the growth of trade must be expected to weaken over time. After the initial devaluations, most east European currencies have appreciated in real terms, and unit labour costs have been increasing. Similarly, price and foreign trade liberalization has removed the administrative constraints on trading activities, but it does not guarantee the expansion of new, profitable exports. The market reforms create the possibilities for trade, but not the trade itself; for this to happen, a number of other conditions have to be met. First, enterprises in the transition economies have to be willing and able to respond to these new possibilities: this requires further reforms in the enterprise and banking sectors, including restructuring and privatization. Second, resources have to flow into potentially viable export sectors to ensure restructuring; but factor markets in transition economies are imperfect, and the inflow of FDI has been below expectations. Third, the prospects of future profits in export sectors are still blurred by the uncertainties surrounding domestic macroeconomic policies and the long-term security of access to western markets.

49. Some of these constraints are clearly beyond the control of the transition economies, but many can and must be addressed by more innovative domestic policies. Sustained growth in the transition economies can only be assured if it is based on a recovery of fixed investment and a continued expansion of exports; along with financial stabilization and fiscal consolidation, these should be the key policy priorities in transition economies.

3. **Internal barriers to export development and enterprise competitiveness**

50. In many cases traders in the transition economies responded quite well to the collapse of the former trading system. Substantial trade was reoriented from eastern to western markets. However, continued improvement is required if the external sector is not to emerge as a constraint on output. This in turn will mean dealing with a number of internal barriers that can be seen at the national and at the enterprise level, the most salient of which are described below.

(a) **Main obstacles to trade at the national level**

(i) Payments

51. One of the principal difficulties faced by traders concerns payment-related problems. Until and unless enterprises can be assured of prompt payment for goods and services, there is no real basis for trade. The causes of payments difficulties include high levels of debt, high interest rates and high taxation; the inadequate and inexperienced financial sector; the lack of adequate export credit and export insurance facilities; and the difficulties in enforcing contracts and in implementing bankruptcy laws.

(ii) Infrastructures

52. Exporters are severely handicapped by the lack of modern efficient telecommunications and a secure and reliable transport system. New investments are required to bring these infrastructures up to the necessary standard. Also Governments themselves have added to the transport problems by setting up costly and time-consuming trade procedures, involving the processing of Customs documentations and the collection of transit fees.

(iii) Poor channels of information

53. At the national level, Governments, business sector associations and chambers play important roles in the channelling of information about market opportunities and market access conditions. But in most transition economies, Governments still play only a marginal role in information provision while business associations and chambers are in the process of being developed.

(b) Main obstacles at the enterprise level

(i) Low productivity

54. The large size of plants, overmanning and poor utilization of labour and machinery means that many firms suffer from chronically low levels of productivity, which cannot be offset by lower wages.

(ii) Management and human resources

55. While creating excellent managers from a technical and scientific standpoint, central planning isolated them from direct contact with their suppliers and customers. Most enterprises in fact never developed an in-house capability to undertake an efficient marketing of their products. Under the distorted structure of incentives under central planning, managers did not have to elaborate strategies to sell their products to the domestic, let alone to foreign markets. This, however, varies; in some countries, like Hungary, enterprise managers had much more contact with, and hence knowledge of, foreign markets.

BOX 2
PRODUCING TRACTORS IN MINSK AND IN COVENTRY

A typical example of a plant suffering from poor productivity is the Belarus tractor factory in Minsk. With a total workforce of some 30,000, of which only about one third were directly employed in the production of tractors, it produced some 80,000 tractors per annum. The same year, the Massey Ferguson Tractor Plant in Coventry, England with just under 2,000 employees produced 120,000 tractors. Even when one takes into account the fact that the Coventry plant is modern and more automated than the one in Minsk, the difference in productivity is nevertheless highly significant.

56. Workforces have a high level of skills, which even if these are not fully adapted to the requirements of the market place, makes them potentially

competitive. However, discipline, work attitudes, working conditions, wages, etc. are poor which manifests itself in poor workmanship and absenteeism. In addition, there is large overstaffing with many employed in activities - constructing and maintaining housing complexes, many hospitals, schools, etc. - extraneous to the production activities of the enterprise.

(iii) Plants and equipment

57. With few notable exceptions, the majority of enterprises are housed in large, antiquated, badly maintained buildings that are filled with equally large, heavy, ageing machinery and equipment. Many enterprises do have automated machinery but they tend to be under-utilized. Modern machinery can create bottlenecks if used alongside the far slower, older equipment. Also the poor state of many factories discourages owners from installing the most expensive and latest equipment.

(iv) Products and market-related problems

58. Many of the products currently manufactured in transition economies fail to meet the stringent regulatory (e.g. health and safety, environment) and design specifications enforced in the west. Product quality falls in many cases far below international standards. While quality controllers may generally be able to ensure a product's correct compliance to standards that can be measured physically, chemically, etc. they generally lack the criteria in which to judge the subjective characteristics of products, such as design, surface, finish, style, colour, etc. As a result there are many products that comply exactly to specifications in terms of dimensional tolerances, durability or performance, but whose visual impact and presentation leave much to be desired.

(v) Costing and pricing

59. Having been brought up in an era when all prices were fixed by the Government, enterprise managers lack the basic know-how on the correct costing and pricing for their products. In many cases, products are offered at too low a price, because their full costs of production have not been calculated correctly and their quality, design and development costs have not been reflected in the price.

60. In other cases, the price asked for a product is far too high compared to similar products offered by competitors. This unsatisfactory situation will continue until proper costing and pricing techniques and know-how are acquired by the enterprises, and the number of accountants in the country increases.

(vi) Delivery

61. On-time delivery of products to the customer is one of the deciding factors for sustained market penetration. Customers will refrain from purchasing even the highest quality products that are competitively priced if these cannot be delivered within an agreed delivery schedule. Enterprises from transition economies have difficulties in meeting such contractual obligations particularly in the regional markets due to transport and transit difficulties. The customer of course does not care whether the delay is due to suppliers or someone else's deficiencies; the basic problem is ensuring predictability of delivery.

(vii) Export packaging and labelling

62. The non-availability of satisfactory packing materials and inadequate labelling is a common problem for enterprises in this region. Good packaging and labelling are essential to prevent damage in transit and for a competitive presentation of products to customers. Packages and labels should be sufficiently attractive and designed in such a way that they help advertise and sell the products. The text printed on labels must always be in the language of the customer's market and must comply fully with that market's often quite complex labelling regulations and requirements.

4. Access to markets

(a) The Uruguay Round as a framework for market access

63. When the Uruguay Round of trade talks between the Contracting Parties of the GATT began in 1986, the Soviet bloc was still a political reality. The Council for Mutual Economic Assistance (CMEA) was the principal trade framework for the countries of central and east Europe, and their economies were subject to socialist central planning. The eight long years of trade negotiations coincided with the collapse of the Soviet system, the demise of the centrally-planned economies, and the re-entry of the successor countries to the world economy. The successful conclusion of the Uruguay Round and the imminent establishment of the World Trade Organization now provides the framework for the transition economies to liberalize their economies and adjust to free market trading conditions.

64. The Czech Republic, Slovakia, Hungary, Poland and Romania are contracting Parties to the GATT and will become founder members of the WTO. The GATT Secretariat understands that all the transition economies wish to join the WTO in the medium term, but many will need time and substantial technical assistance to adapt their trade policies and economic structures to the free market rules. In the meantime, there will be differential impact on those transition economies who are GATT members and those who are at an earlier stage in the transition process.

65. Overall, the GATT Secretariat forecast that the Uruguay Round would expand world trade by between 9 and 24 per cent.12/ The extent to which transition economies benefit will in large measure be dictated by their capacity to participate in international trade and their competitiveness. The transition economies are marginal to the world economy, accounting for less than 2.5 per cent of world trade in 1992.13/ But the Uruguay Round should be seen as a permissive framework which should encourage the transition economies to accelerate their adjustment processes.

66. The main results of the Uruguay Round may be summarized as four-fold:

- market opening measures
- stronger rules on free and fair trade
- new international rules on services, intellectual property and trade-related investment
- a new international agency: the WTO.

67. These measures will have combined quantitative and qualitative effects. In the case of the transition economies, the short-term impact may be negative - for example, tighter controls on environment-related trade - but in the medium to longer term they are expected to benefit substantially from the liberalized trade framework, probably by more than the most-developed economies. Agriculture and textiles, notably, are two sectors which should benefit significantly from the conclusion of the Uruguay Round.

68. In the case of those transition economies who are GATT Contracting Parties, the benefits will be more immediate. At the same time, however, it should be stressed that the beneficial effects of the Uruguay Round on their exports to their major markets in the European Union will be overtaken by the Europe Agreements. They provide an increasingly favourable framework for reducing barriers to trade between the EU and the Czech Republic, Slovakia, Poland, Hungary, Romanian and Bulgaria.

69. Empirical evidence from Slovakia, Hungary and Poland confirms the impossibility of firm qualitative estimates of the impact of the Uruguay Round. So much depends on the capacity of the transition economies to respond to market demand and to produce competitively to meet the required quality standards. There are pervasive expectations that the Uruguay Round will prompt more east-west joint ventures, especially in services. Moreover, the fact that the GATT members in east Europe will open their markets, bind their tariffs, and dismantle protectionist quantitative restrictions is likely in turn to encourage western investors to set up in these transition economies, not only to supply the domestic market but also for intra-regional exports.14/

70. Russia, the largest trading entity among the transition economies, is not a GATT Contracting Party and did not participate in the Uruguay Round. It is anticipated that the Russian Federation will negotiate accession to the World Trade Organization later in the decade. The majority of Russian commodity exports already meet minimal tariff barriers. For Russia, the priority is to ensure that the Uruguay Round does not result in more discrimination against its processed exports. Russia seeks to establish equality as a basic principle within a comprehensive, global trading system. But the Russian economy is still subject to substantial State regulation and the transition process has yet to be completed.

71. The Trade Policy Review Mechanism established in the Uruguay Round will act as a means of imposing discipline on the transition economies regarding their trade policies. It will also offer them an assurance of access to third country markets and reinforce a rule-based international trade environment.15/

(b) Access to western markets

72. Greater market access is considered one of the most effective means of supporting the reforms: not only does it strengthen the capacity to import, but it facilitates structural adjustment and the development of a new pattern of trade, based on comparative advantage reflecting new relative prices. Greater access to western markets can also help to stimulate competitive forces in transition economies by subjecting firms to competition from foreign, import-competing firms.

73. Many transition economies, however, have complained that various measures taken by western Governments have limited the access of their goods to western markets and have harmed their trading performance. On the other hand, in the past five years, an array of new trade agreements and unilateral actions has resulted in a major liberalization of trade relationships between the west and the transition economies. These accords have facilitated the growth of eastern exports to the developed market economies, which has partially offset the loss of trade with their former CMEA partners, and contributed to the dramatic reorientation of their trade flows toward the west. The degree to which western markets have indeed opened to producers from east Europe can be examined in terms of western countries' policies on (1) tariffs; (2) non-tariff barriers; and (3) other factors that may restrict trade.

(1) Tariffs - Most Favoured Nation (MFN), General System of Preferences (GSP) and Preferential Trade Agreements (PTAs)

74. Concerning the award of Most Favoured Nation (MFN) and General System of Preferences (GSP) status to transition economies, it should be noted that since the 1960s and 1970s all transition economies had benefited from MFN status in western Europe and Canada. The US, however, granted MFN to Hungary, Poland and Romania only very recently. The European Union granted MFN status to the ex-USSR in 1989 within the framework of its Trade and Cooperation Agreement. Currently, new Partnership and Co-operation Agreements are being negotiated with each of the newly independent states of the former Soviet Union; they will replace the Trade and Co-operation Agreement and be again based on MFN treatment.

75. Under **GSP**, western industrialized nations give preferential rates of duty to less-developed countries, without receiving reciprocal trade concessions from them; sensitive products are usually excluded and ceilings are set on the benefits available to any one country for a specific product. GSP rates are not binding, they can be revoked unilaterally in case of export surges and other circumstances. Obtaining GSP status improves in principle the ability of transition economies to penetrate western markets. In January 1993 GSP was granted to several CIS countries by the EU. The European Commission estimates that, on the basis of current trade flows, some ten per cent of imports from CIS countries are eligible for GSP treatment, and that with optimal use of GSP by CIS countries, the EU's weighted average tariff on industrial products would be only 0.3 per cent.16/

76. The EU is currently negotiating a new generation of bilateral agreements with the NIS. As and when they enter force, they will in each case replace the 1989 Trade and Co-operation Agreement with the ex-USSR, which remains the contractual basis governing merchandise trade with the Newly Independent States (NIS) (other than the Baltic States). The Partnership and Co-operation Agreements will include chapters on Trade in services, the establishment and operation of companies, capital transfers and intellectual property protection. They will also provide for consultations on competition matters. So far, PCs have been negotiated with several NIS countries. The PCAs will be non-preferential. However, those negotiated with the NIS provide for discussions in 1998 to decide whether negotiations on a free trade area should be initiated.

77. Preferential trade agreements (PTAs) offer the most substantial tariff reduction. The Europe Agreements (signed with the EU) and Free-Trade

Agreements (signed with EFTA) constitute significant trade liberalizing measures. The Europe Agreements cover all goods, but only provide for free trade in industrial products. For agricultural products they provide for reciprocal tariff concessions. Free trade in industrial products is to be achieved in an asymmetric manner, with the EU dismantling its own trade barriers earlier and faster than each Associate country.

78. By 1 January 1995, all EU tariffs on industrial imports from Europe Agreement associated countries had been completely abolished. The only exceptions are these countries' steel products, for which the remaining tariffs are to be abolished by the end of 1995, and textile products covered by the Multi-Fibre Arrangement which is due to be tariff-free by the end of 1996. For the latter, some quantitative restrictions will also remain until 1 January 1999. It should be noted that the Essen European Council in December 1994 agreed that the liberalization timetable for the Bulgarian and Romanian Europe Agreement should be harmonized with the timetable of the earlier negotiated Agreements (i.e. those with the Czech and Slovak Republics, Hungary and Poland). The Baltic States also started to benefit from preferential access to the EU market as of 1 January 1995 with the entry into force of Free-Trade Agreements.

79. The Uruguay Round agreement will have a differential impact on market access in the ECE region. Since 1 January 1995, the transactions of those countries which conduct their trade on an MFN basis are subject to lower tariffs as a result of the implementation of the first of five equal reductions in scheduled tariffs. As regards those transition economies enjoying preferential arrangements, the EU Europe Agreements and EFTA Free Trade Agreements (FTAs) stipulate a reduction in the original tariffs (i.e. the so-called basic duties) in the light of the Uruguay Round results. Implementation of these reductions will preserve, at least in part, the preferences accorded under the association agreements and the FTAs. In those cases where tariffs have already fallen to zero, and probably in some where they have not, the exporter's preferences will be eroded and thus lead to greater price competition from third countries (the erosion of preferences benefiting Bulgaria and Romania is less pronounced due to the lagged implementation of their interim agreements). In 1995 the Baltic States will have benefited, first, from the implementation of tariff cuts under their FTA's with the EU and, secondly, from the further reduction of basic duties in those agreements that are linked to the Uruguay Round reductions.

(2) Non-tariff barriers

80. Quotas, voluntary export restraints or price regulations, the Multi-Fibre Arrangement (administrative sharing of available quotas for textiles, targeting transition economies as State-trading countries) have been largely eliminated, as the enterprises are no longer considered to be from State-trading countries. Those non-tariff barriers which remain are concentrated in "sensitive" sectors (i.e. agriculture, iron and steel, chemicals, textiles and apparel). This protection partly offsets the favourable impact on trade brought about by the lowering of traditional trade barriers (e.g. tariffs and quotas) in western markets. Contingent protection may restrain the exports of goods in sectors other than those to which the specific measures are applied. All exporters (and potential foreign investors) may feel that their goods, too, will become a target for protectionist actions and, as a result, reduce their sales (investments) below what they would otherwise be. There is a

danger too that the use of these instruments will have a knock-on effect on transition economies. On the other hand, the EU has now abolished all specific quantitative restrictions which previously applied to State-trading countries. Safeguard clauses have been applied in the case of aluminum. Seven categories of products exported by Russia have been subject to anti-dumping duties and eight others are under investigations. If concluded, the total volume remaining affected would represent less than 1 per cent of total trade.17/

BOX 3
HIGH TECHNOLOGY PRODUCTS FROM THE EAST

Some transition economies have identified problems of market access for their high technology products. However, as regards standard protection, evidence of particularly high tariffs can be found in neither the EU nor in the United States.

In the EU, for instance, the MFN import tariff rate for satellites is 6.4 per cent. For military airplanes and helicopters the MFN rate varies between 5 and 15 per cent. For electronic components and microprocessors it is never higher than 14 per cent and for telecommunication equipments it is around 7.5 per cent. These rates cannot be considered as being especially high, when compared for example with the 20 per cent MFN import duty faced by footwear products, or with the import regime of agricultural goods. Evidence of significant non-tariff protection that would apply to high technology products in general could not be found, either.

Source: Code des Douanes 1994, Union Européenne, Customs Code 1994, USA.

81. However, there is inevitably a time lag between adopting new measures and a general recognition of the changed situation in the transition economies. Perhaps more needs to be done by State agencies to create greater awareness in the private sector of new opportunities.

(3) Other actions that may restrict trade

a. Health, safety and environmental measures

82. Marking and packaging requirements, quality certification measures, environmental standards on products and packaging and transportation can also represent trade barriers. Information on these measures is often very difficult for exporters from the transition economies to obtain.

b. Anti-dumping and countervailing duties

83. While technically not barriers, it is often suggested that anti-dumping or countervailing duties are used to limit competition because the investigatory procedures are often long and expensive. Transition economies face specific problems. Within the framework of the GATT, special procedures were established for anti-dumping enforcement on imports originating in so-called State-trading economies that require references to a third country's

prices. This procedure was considered unfair by transition economies because of the dramatic differences between their economic structures. Russia for example, is still treated as a State-trading country, but has abolished its monopoly on trade.

BOX 4
ANTI-DUMPING PROCEDURES

Another complaint of the transition economies is the administration and verification of the cost/price questionnaire that producers charged with dumping are required to fill out: too short delays; differences in accounting systems; unavailability of relevant information on the enterprise; artificial nature of exchange rates; etc. On the other hand, many western market economies permit the review of anti-dumping measures if an interested party makes a formal request for it and shows that circumstances have changed.

84. Dumping is a threat when economies suffer from allocative and productive inefficiencies. For allocative efficiency, relative prices must reflect costs of production. For productive efficiency, firms which do not use the most efficient combination of inputs to produce given outputs must pay a penalty (ultimately, to be declared bankrupt). However in transition economies, as a result of the widespread failure of enterprises to pay debts and the lack of enforceable bankruptcy procedures to rid the markets of non performers, allocative and productive efficiency it is argued, become distorted.18/ Consequently, it is suggested, these distorted features can make a pricing strategy based on incurring losses in the short term (e.g. dumping through predatory pricing) a sustainable strategy for certain firms. Clearly this can create trade frictions with western partners. The western market economies which use anti-dumping measures against transition economies, argue that their rationale is not to protect local industries from eastern European imports, but rather to create or restore fair trading relations in accordance with the multilateral trade system.

85. The effects of anti-dumping on transition economies can be assessed by looking at the direct and indirect effects of such actions. As far as the central European economies are concerned the direct effects appear rather marginal. As seen in Table 2, the number of anti-dumping cases begun by the European Union has declined steadily since 1988. In addition EU anti-dumping measures cover 0.32 per cent of EU imports from Bulgaria, the Czech Republic, Hungary, Poland, Romania and Slovakia, and 0.36 per cent of industrial imports from these countries. Relatively more anti-dumping actions however have been taken against CIS exporters.19/

86. Probably more significant has been the indirect effects of anti-dumping measures, although measurement of such effects on both inward investment and on trade is very difficult.20/ However, studies on the indirect effects of trade caused by anti-dumping have identified the very threat of action as having a strong trade deterrent effect.21/

Table 2
Initiation of EU anti-dumping cases against the CEECs

	1988	1989	1990	1991	1992	1993
Bulgaria	1	1				1
CSFR	1	1		1		
Hungary	1	1		1		1
Poland	1	1		2	1	
Romania	2	2			1	
Total	6	6	0	4	2	2

Source: Costello et. al. (European Economy 1994).

c. Rules of origin

87. Rules of origin are conditions a given product must meet in order to benefit from a preferential trade regime. In the Europe Agreements, the "local content requirement" is 60 per cent on the average, depending on the product.22/ Materials imported from third countries for processing (i.e. the EU or any Associated State) cannot account for more than 40 per cent of the value of the inputs used in the production of the goods concerned. The Essen European Council in December 1994 decided that the diagonal cumulation provisions already in place for countries with Europe Agreements should be extended to all six Associated countries. Diagonal cumulation of rules of origin allows imports imported from any associated country to be considered as local in calculating local content. This measure was aimed at promoting trade integration between the Associated States, and has considerable potential for expanding trade.

d. Protection of property rights

88. The Europe Agreements state that protection of property rights can be a ground for justifying restrictions on trade. This may become a problem for the Associated States, since the "doctrine of exhaustion" will not be applied within the framework of the Europe Agreements.23/ This means for instance that cheap products from central and eastern Europe can be prevented from entering the EU markets as parallel imports. This feature may become a negative factor, since the Associated States are trying to escape from the situation of dependency, created by the concentration of their exports in a few low value-added products and raw materials.

89. To sum up, for States benefiting from preferential trade agreements with western countries, progress has been made towards improving market access. For non-beneficiaries the situation is more difficult. Although 83 per cent of Russia's exports to the EU enter tariff free, and the weighted average tariff for Russian industrial exporters to the EU is estimated at only 1.1 per cent (due to the high share of raw materials in Russia's exports), for producers of so-called "sensitive goods" the market-access conditions are clouded in uncertainty. Despite the progress made to date, many individual

enterprises in the CIS still fear that western markets are closed to them. The various trade policy instruments which have been used to limit access of their goods are often difficult to understand. More meetings and other events which can provide information to market operators in transition economies on these trade policy instruments are desirable and necessary.

(c) Access to eastern markets

90. The decline in trade between the countries of the former CMEA was steep, particularly amongst the States belonging to the CIS. Since the degree of trade dependence in the region was extremely high, the re-establishing of some trade relations could be positive. In particular, it would allow the producers of capital goods which are not able to compete on western markets to export again to their traditional markets. Thus, the revival of intraregional trade could provide exporters with time and resources to restructure in order to gain competitiveness.

91. In order to revive intraregional trade, certain States have signed agreements on a bilateral and multilateral basis to liberalize their trade. The Central European Free Trade Agreement (CEFTA) was signed in December 1992, by the Czech and Slovak Federal Republic, Hungary and Poland in Visegrad (hence the so-called "Visegrad group"). It entered into force in March 1993. All barriers on mutual industrial trade are to be dismantled by 1 January 2001. The Baltic Free Trade Agreement (BFTA) was signed in September 1993 by Estonia, Latvia and Lithuania. It entered into force in April 1994 and covers mostly industrial goods. In September 1993, all CIS States with the exception of Ukraine (which is an associated member of the CIS) signed a treaty envisaging the establishment of an Economic Union in which the free circulation of all factors of production would be guaranteed.

92. Having significantly liberalized their import regime when the reforms were launched, the transition economies have tended in some cases to re-introduce tariff barriers. Russia for instance adopted in July 1992 an average import tariff rate of 5 per cent. Two years later, after several revisions, the average tariff rate was increased to 14 per cent, with peaks at 100 per cent of certain goods. Recently, a partial revival of regional trade has been observed among central European countries, which may reflect the beneficial effects of the CEFTA. On the other hand, the entry into force of the Baltic FTA and the CIS Economic Union are still too recent to have had any major impact on intraregional trade.

93. However, although trade agreements have led (or will lead) to tariff reductions amongst the transition economies, many non-tariff barriers remain and new ones have been established. These include the adoption of a growing number of new standards and regulations. For example, some countries which opted for future accession to the European Union are trying gradually to upgrade their sanitary, ecological, and other requirements to align them with those of western Europe. This can create barriers to mutual trade as regional producers, even if they are aware of the latest regulations, are not always able to meet the new requirements.

5. Relative importance of external and internal barriers in the trade of transition economies

94. Having examined both internal and external barriers to trade of goods from transition economies the following issues can now be assessed: (i) the degree of importance market operators attach to these barriers; (ii) the relative importance of external and internal barriers to exporters in the transition economies; and (iii) the extent and effectiveness of the western technical assistance directed at alleviating the problems identified by the market operators.

(i) The relative importance of external and internal barriers to exporting in transition economies

95. According to a survey of 42 Romanian exporters carried out by the UN/ECE in conjunction with the Centre for Promotion of Small- and Medium-sized Private Enterprises in Bucharest, the following areas, ranked in order of importance, have proved particularly troublesome:

a. lack of information on foreign markets, prices and standards, and insufficient help from the domestic export promotion agency;

b. deficient infrastructures and, in particular, problems related to Customs procedures;

c. lack of low-interest export finance and payment-related problems;

d. insufficient quality of Romanian goods and services, which prevents them from meeting international standards;

e. the lack of knowledge of Romanian products on international markets and their bad reputation;

f. restrictive market access conditions (tariff and non-tariff barriers);

g. problems in meeting the price and quality level of international standards;

h. governmental and bureaucratic obstacles (e.g. corruption);

i. embargo-related impossibility of using the Danube river for transport.

96. An OECD survey was carried out a few years earlier. This tends to present the same type of problems faced by exporters, namely:

- infrastructures (telecommunications, transport);
- underdeveloped banking sector and financial services;
- inefficient Customs administration and other border-crossing facilities;

- information: excessive and frequently changing regulations on all aspects of foreign economic relations: delays in receiving information on domestic regulatory changes, lack of information on longer-term government economic policies;

- insufficient access to western commercial information: prices, regulations (the inability to deliver GSP origin certificates, incorrect registration of textile quotas);

- technical barriers: standards, quality problems.

97. A survey of importers undertaken by the OECD, involving 2,000 purchasing professionals from Germany identified:

- negative quality standards;
- credit worthiness;
- Customs service;
- meeting delivery times.

98. Other surveys of importers confirm that the main barriers were the same as those identified by domestic firms (communications, Customs services, unstable regulatory environment, payment difficulties).

(ii) The relative importance of external and internal barriers to exporting in transition economies

99. The relative importance of external and internal barriers depends on the country, its competitiveness, the sector and industry. For Romania, the survey showed that internal factors were more commonly cited than external barriers. Market access problems were ranked only sixth in terms of their importance as trade barriers. The OECD survey furthermore confirms this picture that domestic barriers were rated by exporters from the transition economies more highly than external ones.

100. Results from questionnaires, while illustrative, do not always provide the reliable indicators of reality that researchers are looking for. However in the absence of econometric analyses to determine the relative weight of internal and external factors, it is these or specific sectoral analyses that researchers are left with to draw their conclusions.

101. If we take east European agriculture, which is often cited as an example of a sector where the transition economies possess comparative advantages (Bulgaria, Hungary and Poland were traditionally major exporters of agri-food products) but who do not reach their full potential because of the protection of western markets, we find, on closer examination, that such competitiveness may be exaggerated.

102. On the supply side, in the first stage of transition, part of the supplies for available exports were actually surpluses resulting from decreased domestic demand, not production for export *per se*. Production too declined significantly, due especially to uncertainty of farm policies and restructuring, drop in input use and drought. Indeed, in some countries, the shortage of supplies led Governments to establish a temporary ban or control on exports. Low productivity and efficiency of agricultural holdings is another crucial obstacle, which may be explained, in particular, by temporary

disturbances due to land reform and farm restructuring, decrease of investment in the sector, low input use (chemicals, certified seeds), obsolete equipment, and lack of skills and management abilities. For instance, in the livestock sector, the breed mix and the feed conversion rate are frequently rather poor.

103. The organization of markets in agricultural products, especially institutional and marketing aspects, have broken down and now need to be restored. Market transparency has to be established: information on supplies and outlets, prices, quantity and quality requirements, market trends, etc. is required; likewise for stock exchange, wholesale markets, farmers organizations and professional chambers. The absence of such institutions hamper both domestic and external trade. Sales abroad strongly need export facilities such as export promotion and credit. In contrast, in western countries there are highly organized trading and processing corporations, which provide fierce competition which is extremely hard to meet.

104. Because of low productivity, rather high costs and poor marketing, prices of agri-food products from the transition economies are frequently too high compared to international prices. The challenge of transaction lies precisely in achieving a structural shift away from these problems. Adequate investment and technical assistance can bring about dramatic improvements and there is evidence to support the view that east European agricultural markets are benefitting.

BOX 5

COMPETITIVENESS OF HUNGARIAN PIGS

Hungarian pigs have an average lean meat-to-fat content of 46 per cent; compare this to 60 per cent plus lean meat content of Danish pigs and it is obvious that Hungarian producers start with a distinct disadvantage in the highly competitive west European market.

Source: "Not what it seems: EC quotas can appear protectionist but are they the only obstacle to trade?", April 1994, Business Central Europe.

105. On international markets, especially those in western countries and the European Union, the quality of the products is the key factor for competitiveness. Quality covers various requirements: commercial, sanitary, phytosanitary, as well as presentation and packaging. Labelling for consumer information, including environmental aspects (eco-labelling), require increased attention by producers, sellers and public authorities. As transition economies were in the past mainly oriented towards markets in central and east Europe, quality was not given so much importance. Accordingly, in the transition economies which are major exporters of agricultural products, the promotion of quality is a priority in new food and agricultural policies, with the primary objective to comply with international requirements (European Union, UN/ECE commercial quality standards).24/

106. Thus, while there are clear external barriers to the access of east European agricultural products to western markets, e.g. variable levies, subsidies and quotas, the lack of competitiveness of this sector in transition economies means that even if these barriers did not exist there would be no certainty that sales of east European products would expand unless the products themselves were improved. Technical assistance and agricultural modernization programmes will play an important role in upgrading future production.

(iii) The extent and effectiveness of the western technical assistance directed at alleviating the problems identified by the market operators

107. The OECD's (CCET) Register contains information on technical and humanitarian assistance provided to transition economies by OECD countries. Several barriers were chosen to see whether (and how much) western countries' assistance had been targeted to these areas:

- Customs administration: most assistance centres on training of Customs officials, automating information collection and designing legislation. Only three projects mention supplying equipment. No project directly mentions efforts at increasing the efficiency of services for exporters or importers;

- technical barriers to trade (health and safety measures, marking and packaging requirements, quality certification procedures): the assistance projects focused on joint seminars, help in standards and other regulatory drafting;

- information on market access problems: no specific assistance projects were on record, but the ITC and other agencies are currently implementing several projects;

- telecommunication and banking: the register search revealed, not unexpectedly, that a large number of well-funded assistance programmes are focused in this area, but are not necessarily targeted as assistance for exporters.

Notes

1/ Comparison of pre-reform and post-reform trade flows is difficult as it requires conversion of trade flows expressed in largely artificial prices and in transferable roubles into dollar values. Statistical coverage of trade transactions has also changed as a result of the unification of rules of statistical reporting which makes temporal comparisons even more problematic. Frequent devaluations and high inflation further blurred the picture of trade, and the comparison of trade levels with GDP levels gives biased results because the official exchange rates are in most cases seriously undervalued. Finally, for some newly independent countries comprehensive foreign trade statistics simply did not exist prior to transition.

2/ See UN/ECE, Economic Bulletin for Europe, Vol.43/91.

3/ Some economists have, however, criticised this concern with competitiveness, in particular focusing on what they saw to be the dangerous implications it had for trade policy. Paul Krugman has for example argued that obsession with competitiveness would lead Governments to misallocate resources through protectionist industrial policies and corporate subsidies. However, generally speaking, Governments, while adhering to the need to increase their countries international competitiveness, have shunned restrictive industrial policies or protectionism and rather given their support to further liberalization of world markets, as symbolized in the GATT trade agreement, and to the principle of fair and open markets. They have however tended to take a broader view of the factors leading to competitiveness. See Paul Krugman, "Competitiveness: A Dangerous Obsession", Foreign Affairs 73 (March/April 1994); Peddling Prosperity: Economic Sense and Nonsense in the Age of Diminished Expectations, (New York, N.Y.: W.W. Norton 1994). For a critique of Krugman's views, see Daniel Burton Jr. et al in "Jobs, Trade and National Prosperity" in The Washington Quarterly, Autumn 1994.

4/ Commission of the European Communities; Growth, Competitiveness, Employment: The Challenges and Ways Forward into the 21st century. [COM (93) 700] (1993)].

5/ Report of the Federal Government on the safeguarding of Germany's future as an industrial location, [Federal Government] (1993); Competitiveness: Helping Business to Win, CM 2563, London: HMSO (1994).

6/ For the methodological problems in using comparative advantage as a means of measuring competitiveness, see D. Williamson, Trade and Industrial Policy in Developing Countries, 1993.

7/ See D. Rosati, "The Economic Interpenetrations between the EC and Eastern Europe: The Consequences for Polish Industry", Brussels 1994 mimeo; L. Halpern, "Comparative Advantage and Likely Trade Patterns of the CEECs", CEPR Discussion Paper Series, No. 1003.

8/ Economic Bulletin for Europe, UN/ECE, Vol. 46 (1994), pp. 57-64.

9/ "International Trade and Technology in Industrial Restructuring in Central and Eastern Europe", John A. Cantwell (mimeo), 1994.

10/ "Industrial Policy: the Role of Government in Promoting Industrial and Technological Development", S. Lall, UNCTAD Review, 1994.

11/ Beyond Free Trade, Ed. D.B. Yoffie, Harvard Business School, 1993.

12/ See GATT-WTO News, 6 November 1994, p.1.

13/ See "The Impact of the Positive Conclusion of the Uruguay Round on Intraregional Trade with Special Reference to the Countries in Transition", TRADE/R.619, p. 16.

14/ See "The Impact of Foreign Direct Investment on the Trade of Countries in Transition: Results of a Preliminary Survey", TRADE/R.617.

15/ See Trade Issues in the New Independent States, Constantine Michalopoulos, Studies of Economies in Transition, No. 7, The World Bank, Washington, 1994, pp. 15.16.

16/ See European Commission document, "Des échanges commerciaux et de l'assistance dans les relations entre l'Union Européenne, les pays d'Europe centrale et orientale et ceux de la Communauté des Etats indépendants", MG/NN/FW, 13 October 1994.

17/ EC informal statistics document on "Anti-dumping measures currently in force: cases involving central and eastern European countries and CIS", 10 September 1994.

18/ D. Begy and R. Portes, "Enterprise debt and economic transformation: financial restructuring of the State sector in central and eastern Europe", Centre for Economic policy Research, Discussion paper No. 695, June 1992.

19/ 20 anti-dumping measures were still in force against products from CIS and Lithuania, mainly in basic chemicals and steel.

20/ Measuring the impact of the indirect effect on inward investment is particularly problematic since one cannot observe investments which would otherwise have taken place.

21/ P.A. Messalin, "The association agreements between EC and central Europe: trade liberalization versus constitutional failure?" in J. Fleming and J. Rollo (ed.), Trade Payments and Adjustment in Central and Eastern Europe and L.A. Winters "VERs and expectations: extension and evidence", Economic Journal, Vol. 104, pp. 113-123, 1994.

22/ L.A. Winters, "The Europe Agreements: With a Little Help from Our Friends", in Center for Economic Policy Research, The Association Process: Making it Work, Occasional Paper No. 11, CEPR, London, November 1992, p.19.

23/ Within the EU, this legal principle prevents property owners from banning sales of "parallel imports" in order to earn excess profits.

24/ For the main exporting transition economies, sales on west European markets are regulated by agreements with the EU and EFTA, including quotas, and minimum prices which are to be progressively adjusted over a transitional period. Prospects for membership in OECD and later in the EU are already now defining the overall framework and the orientations to be followed by agricultural and trade policies of transition economies. On international markets in general, major obstacles for exports come from agricultural support and trade policies and subsidized prices, although the GATT agreement will progressively diminish the level of those subsidies.

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WAYS AND MEANS OF PROMOTING THE EXPANSION OF TRADE IN TRANSITION ECONOMIES

Report by the secretariat

ADDENDUM

PART III

Specific Measures and Conclusions

Note: With reference to its decision C (49) on promoting the expansion of trade for products from the countries in transition in international markets, the Commission at its forty-ninth session requested the Executive Secretary, in consultation with member States of the ECE, to prepare a study containing recommendations on ways and means of promoting the expansion of trade of the countries in transition.

The secretariat has therefore prepared the following study entitled "Ways and Means of Promoting the Expansion of Trade in Transition Economies" in three parts: part I "Executive Summary and Recommendations" (E/ECE/1311); part II "Diagnosis of the Problem" (E/ECE/1311/Add. 1); and part III "Specific Measures and Conclusions" (E/ECE/1311/Add.2).

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WAYS AND MEANS OF PROMOTING THE EXPANSION OF TRADE IN TRANSITION ECONOMIES

PART III

SPECIFIC MEASURES AND CONCLUSIONS

F. SPECIFIC MEASURES TO FACILITATE TRADE

1. Institutional measures

1. Effective national trade promotion and development institutions and services are essential to support a national trade expansion programme, and ensure the pursuance of trade policies through appropriate strategies and operations. Many transition economies have established, or are in the process of establishing, the necessary institutions. 1/

2. The elements of an effective institutional infrastructure can be categorized into four main groups:

(a) Sector specific, for example institutions/organizations representing producers of agro-based or manufactured products;

(b) Function specific, for example for services in export finance (whether for term loans, working capital or credit guarantees and insurance), packaging, quality assurance, management education, Customs administration (import/export and duty drawback facilitation), etc.;

(c) National/regional associations such as chambers of commerce and industry, bilateral chambers, etc.; and, finally,

(d) A trade promotion and development organization, with overall responsibility for:

- advice to the national authorities on the design and pursuance of the most appropriate trade policies and programmes, and the provision of necessary services, whether from Government, public sector or private sources, and ensuring they are kept informed of the standards required by the exporting community to compete internationally;

- provision of direct assistance to exporters, and potential exporters in trade promotion and development: this includes within-country activities in, for example, trade information, product and market advice, etc. and a wide range of promotional services through foreign-based offices, trade fairs and missions, etc. linked to active market development efforts;

- ensuring an effective coordination and partnership between the facilities and services provided by the other groups comprising the national trade services infrastructure, to avoid duplication and waste of effort and resources.

3. Countries with successful export performances all have efficient trade promotion and development institutions, which perform these functions. They

essentially serve as a catalyst to ensure that the exporting community are provided with the most efficient and effective international standard trade services and facilities, with assured access to reliable information about market trends and consumer requirements.

4. While there are a variety of institutional structures, all the successful trade promotion and development institutions have the following features in common:

(a) They are in the public sector but outside the civil service: this facilitates development assistance, both with, for example, small- and medium-sized enterprises which have particular and sometimes long-term development requirements, and facilitates liaison with other institutions within Government, and in the public and private sectors.

(b) The institutions are led by a Board of Directors composed of senior Government officials (from the production ministries), the finance sector and, often a majority of private sector exporters, selected because of their individual export expertise and willingness to serve in a national capacity, and from different export sectors of the economy.

(c) There is autonomy in direction, management and operations: this includes authority to follow private sector practises in respect of recruitment and remuneration of staff, and in the design and implementation of the institution's work programme.

(d) The institutions have a clearly defined status and responsibility in respect of supporting the national trade development programme, and an agreed relationship with the other institutions concerned with the sector: there is often formal endorsement of the position of the institution by the most senior Government authorities, an important factor in facilitating its coordination role.

(e) The institutions receive their funding from the Government, but are encouraged to seek cost reimbursement for certain services, primarily of a downstream trade promotion and market assistance nature: the institutions seek to avoid duplication with other bodies which provide services and facilities.

(f) The institutions have displayed a flexible approach to their development and have evolved over time to respond to the changing needs of exporters and the requirements of international markets: overall the institutions have sought to provide the export community with services of an international standard, and comparable to those provided to competitors from other countries in major markets.

5. Thus, policy decisions on the status, structure and operations of a national trade promotion and development institution require a very careful analysis of the options, so that the most appropriate institutional arrangements are decided and mistakes, which could make the institution ineffective and a disservice to the exporting community, are avoided.

BOX 1
THE ACTIVITIES OF A WESTERN TRADE PROMOTION ORGANIZATION

A typical western trade promotion organization (TPO) tries to facilitate trading activities between domestic enterprises and the rest of the world. The Swiss TPO (Office Suisse d'Expansion Commerciale, OSEC), performs four main tasks:

- provides foreign economic agents with information on the national exporting economy;
- provides national economic agents with information and advice on foreign markets;
- links business partners and provides information on business possibilities;
- organizes promotion activities and participates in trade-related events (e.g. international fairs);
- assists with many other export-related services.

More than 2,000 Swiss enterprises are members of OSEC, which has three regional offices - one per linguistic area. It works closely with various economic organizations, with the Swiss Government, and with the Swiss representations abroad (embassies, chambers of commerce, etc.). Most of OSEC's services are paid for by the requesting companies, but some basic information services are offered free of charge.

2. International trade standards

6. Standards play a vital role in expanding international trade. The UN/ECE has led the way in establishing international trade standards which provide exporters with objective, reliable information on the requirements for gaining access to international markets. A single international standard, rather than a plethora of national ones, allows exporters to benefit from scale efficiencies. They also reduce the costs for exporters who otherwise would have to travel to their export markets to gain the necessary information and thereby maximize their export opportunities. Internationally agreed standards make for harmonization and predictability, and create a permissive environment for trade rather than a protectionist one. In contrast to international standards, purely national standards can have the opposite effects. The sheer diversity of standards means that some countries exclude themselves from export markets because companies simply do not find it economical to make the necessary adaptations. It is this area of frustration which has required the European Community, for example, to harmonize standards throughout the Single European Market, in order to eliminate barriers to trade.

7. Standardization activities were well developed in the planned economy countries of the ECE region. Harmonization of national standards took place at the Council for Mutual Economic Assistance (CMEA) level, and CMEA standards

were mandatory technical regulations in trade between those countries. The standards bodies of the CMEA countries were active participants in international standards work in organizations, including the UN/ECE, the International Organization for Standardization (ISO) and the International Electrotechnical Commission (IEC). Verification of conformity with standards was facilitated by the fact that most industrial production took place in large units and by the considerable legal authority vested in State inspectors.

8. The economic reforms resulted in a decentralization of production from large conglomerates into smaller units and sometimes in the emergence of new production, making verifications of conformity much harder at the national level. At the same time, the national standards bodies in most of the formerly planned economy countries were hard hit by budgetary restraints making it more difficult for them to retain qualified staff and, even more importantly, to participate as before in international standards work.

9. As the transition economies increasingly reorient their foreign trade towards western Europe, the regional standards work carried out in organizations, such as the Comité Européen de Normalisation (CEN) and the Comité Européen de Normalisation Electronique (CENELEC) with financial backing from EU and EFTA countries, takes on increasing importance for potential exporters in central and east Europe. Although some of the transition economies are affiliated members and can participate in the technical work of both CEN and CENELEC, they are not allowed to vote. This has prompted the most advanced of them, such as the Czech Republic, to request full membership. This would require statutory changes since at present only EU and EFTA countries can enjoy full membership.

10. One of the most important tasks of any national standards body is to provide industry with reliable and timely information about standards and technical regulations applied at the international, regional and national levels. This presupposes the existence of relatively large reference libraries and the means to disseminate this information within the country. Perhaps as many as 20,000 standards should be easily available within each such reference library and others ordered on specific request. The international and regional standards organizations have well-functioning distribution services but the cost of a given standard, which can be as much as US$ 500, may deter small- and medium-sized companies from acquiring their own copies. The Newly Independent States have difficulties in creating their own standards reference libraries. Many of them will need technical and financial assistance to do so.

11. Most standards require periodic revision. Several factors combine to render a standard out to date: technological evolution, new methods and materials, new quality and safety requirements. To take account of these factors, ISO has established the general rule that all ISO standards should be revised at intervals of not more than five years. This means that roughly 2,000 ISO standards are subject to review and possibly change every year. A highly industrialized European country may wish to make an input into half of these revisions and must be fully informed about other changes in order to keep abreast of new technology.

12. From a trade point of view the most important aspects of standardization policies relate to conformity assessment, i.e. testing and certification.

Even for countries with well functioning standardization and metrological services, it is necessary to gain the confidence of foreign customers and authorities in the competence and integrity of the national testing and certification bodies. Only when such confidence has been created is it possible to envisage mutual recognition agreements and avoid very costly double testing. With this in mind the ECE Working Party on Standardization Policies has concentrated much of its assistance to transition economies on the question of conformity assessment and metrology in testing. There is continuing demand for workshops on the subject and hands-on training in metrology.

13. To sum up, the transition economies in general have the basic structures of national standards certification and metrology services in place. Their ability to cooperate effectively with the international and regional bodies concerned is, however, severely hampered by financial constraints, notably the shortage of foreign currency. It may be noted in this connection that west European standards bodies normally devote at least two thirds of their activities to regional and international work. One way for standards bodies in transition economies to earn the foreign currency necessary for their international and regional activities is by creating new mandatory certification requirements for imported products. In some cases, this may be justified to protect consumers from substandard products. However, international trade law and good practice (WTO and UN/ECE recommendations) require that imported goods be treated no less favourably than domestic goods. It will therefore be necessary to extend any such certification regulations also to domestic goods and to apply them only to cases where it is clearly warranted on grounds of public health and safety or environmental protection.

14. Over a period of years, national standards bodies in transition economies may be expected to sell their standards, certification and metrology services to producers and traders. There is a clear tendency in western countries for Government contributions to this kind of work to decrease and to be more clearly earmarked for activities which are in the public interest rather than in the interest of any local producers. However, for transition economies it will be necessary to maintain a relatively high degree of public financing of standardization and metrology activities until such services have developed closer working relations with the restructured industrial and trade partners.

(a) Role of commercial quality standards in agricultural products

15. Commercial quality standards facilitate trade in perishable products between producing and importing countries as they provide essential information. The standards establish a trading language of recognized levels of quality ("Extra", class I, class II, class A, etc.), size categories, packaging, presentation and labelling requirements intended to reflect current marketing practices. As such, the standards have the recognized potential to open trade doors in foreign markets. In considering the role of ECE commercial standards, the highly competitive nature of the western markets must be taken into account as perishable food items not only compete against their "own kind" (apple against apple), they also must compete against a wide range of other fresh fruit such as pears, plums and peaches, for example, as well as exotic items such as mangoes, papaya and kiwi.

16. The present situation in most countries of east and central Europe includes a lack of certification and conformity infrastructure matching west

European practices, and a lack of harmonization of national standards with existing international norms such as those elaborated by the ECE. The standards clearly prohibit lower levels of quality entering the market place and they introduce size classifications which exclude smaller sized fruit and vegetables. This serves to encourage producers to improve their production practices to meet the higher quality demanded in the market. Given the highly competitive nature of the market, the perishable nature of these products and the strong influence of consumers in western markets, quality factors should not be seen as barriers to trade.

17. Market forces, in particular the influence of consumer buying habits, introduce a dilemma in the field of commercial standardization, the intent of which is to elaborate quality standards reflecting actual trade practices. In an industry driven by consumer demand in a dominant market such as western Europe, to lower quality standards for certain items in order to meet the initially lower quality of similar food items in east and central Europe directly impacts the role of commercial standards. As an example, lowering the minimum level of commercial quality for apples in order to accept greater quantities of those grown in CIS countries in western markets would result in apples of a visibly lower quality entering into competition with much high quality fruit, including other apples, from western Europe, New Zealand, the United States and Chile. As consumers readily judge quality for themselves in the case of fresh fruit and vegetables, experience has shown that such decisions repeatedly act against lower quality.

(b) UN/EDIFACT, Trade Facilitation and Transition Economies

18. UN/EDIFACT is the international standard for electronic data interchange (EDI). The acronym stands for United Nations/Electronic Data Interchange for Administration, Commerce and Transport. EDI is a technology for computer-to-computer communication of structured messages, such as purchase orders, invoices and Customs declarations. It endeavours to increase productivity, reduce costs and minimize error by eliminating unnecessary paper and manual intervention in business transactions. UN/EDIFACT provides the rules for EDI on a global basis.

19. There are several factors to be considered before transition economies can benefit from using EDI and UN/EDIFACT in international trade. Telecommunication infrastructure is typically the first consideration for the electronic exchange of information, though this might be overcome by the physical exchange of diskettes or other electronic media. There are more important requirements than telecommunications, however. The first is understanding international trade procedures and documentation; the second is well-established international trading relationships.

20. As new enterprises and Government administrations in transition economies begin to automate their work, they should structure their information systems and databases according to UN/EDIFACT rules and data definitions. Such a step would greatly simplify future adoption of EDI, but it will not happen if those responsible for this work in companies and Government are unaware that such international standards exist.

21. In order to be integrated into the international trade system, transition economies must recognize the importance of improving the quality of their manufacturing processes. Even if they cannot yet afford to invest in state of

the art equipment and machinery, countries can improve their competitive position by adopting international norms of quality assurance, such as the ISO 9000 standards, and advanced trade facilitation techniques.

22. These techniques, including EDI, are concerned with improving the quality of the administrative processes that support trade transactions. A transition economy may not be ready for EDI: it may not yet have an advanced telecommunications network, its enterprises may not have sufficient computer technology. But other trade facilitation techniques can still be applied immediately to improve Government and commercial procedures. Trade facilitation is more than a technical exercise, it is a strategy for improving a country's ability to trade. UN/EDIFACT provides an internationally accepted set of rules which ensure that this strategy will be compatible with current and future trading partners worldwide.

(c) UNCTAD: The Special Programme for Trade Efficiency

23. Many of the transition economies participated in the World Trade Efficiency Summit in the USA in 1994. They helped to define the UNCTAD-led Special Programme for Trade Efficiency and the associated Trade Points programme.

24. Trade Points are intended to be enterprise-focused, and are designed to combine trade facilitation, trade-related information, and a gateway to global networking. They presuppose the use of information technology in trade transactions. Trade Points are in the process of being established throughout the transition economies and will have substantial potential to assist exporters to penetrate global markets.

3. **Foreign direct investment**

25. One of the problems holding back trade amongst the transition economies has been the relative lack of intraregional investment and enterprise cooperation. In spite of the impressive speed with which virtually all Governments in the region have opened their economies, their success in attracting FDI, with a few exceptions, has been disappointing. However, in those few transition economies which have had the most success in attracting FDI, the contribution of the latter to trade has already been quite positive. The most salient recent trends in FDI to the region are as follows:

26. The number of foreign investment enterprises in the region has increased dramatically. By the end of the first half of 1994, 111.3 thousand companies with foreign participation had been established in the ex-CMEA region. This represents an almost two-fold increase from the beginning of 1993 (68,903) and a nearly eight-fold increase from the beginning of 1991 (15,000).

27. Measured by value, the size of foreign involvement in the transition economies is much less. By the end of the first half of 1994, the total value of these foreign investments was estimated to be approximately just over US$ 20 billion (20.9). Moreover, the bulk of this investment has been concentrated in a few countries: first in Hungary (almost fifty per cent of the total), then Poland, the Czech Republic and Slovenia. In comparative terms the size of this cumulative investment to the whole region (i.e. over four years) is of the same order as a middle-ranking west European country.

28. Particular problems are faced by the small transition economies; both in the size of investment and in the number of projects they have been able to attract. Small CIS States have fared badly; Baltic States did slightly better although Latvia still managed to attract only 0.1 per cent of the total value of foreign investment to the region.

29. Overall, manufacturing and services have been the main targets. In the Baltic States, the service sector, trade and industrial services have been more attractive to outside investors, while in Russia, over 60 per cent of total FDI has been in manufacturing.

30. The contribution of FDI to the trade of host economies has not been negligible, although this prominence is probably due to the decline in the exports of domestic enterprises rather than as yet any major propensity to export of the foreign subsidiaries in the region. For example, in the CIS during 1991-1993, the value of foreign investment-related exports (which exclude the intra-CIS transactions) grew almost five-fold and amounted to US$ 3.7 billion in 1993. At the same time, the overall CIS exports of the Commonwealth stagnated. At current prices, they increased by 12 per cent in 1992 and then tumbled by 3 per cent the next year. As a result, over 1991-1993, the foreign share of overall exports grew from 1.8 per cent in 1991 to 8.2 per cent in 1993.

31. On the other hand, in 1993, the share of foreign subsidiaries in total exports in Hungary - which accounts for over half of all the foreign capital invested in transition economies - was almost 50 per cent. Between 1991-1992 in individual branches, foreign firms exported 70, 60 and 47 per cent in non-metallic products, machinery and equipment and textiles, wearing apparel and leather, respectively. 2/ Outside Hungary, however, in the other transition economies the contribution of FDI to trade has been less noticeable. In terms of total exports, the share of foreign subsidiaries was 18 per cent in Poland, and 16 per cent in Slovenia, while in the CIS countries the share was 8-10 per cent (excluding intra-CIS trade).

32. The main home countries of foreign investors come from the developed market economies of western Europe. As a consolidated investor, this region accounts for 60-70 per cent of foreign investment in most transition economies. The United States and Germany have become the two single-most important investor countries, each accounting for between 7-20 per cent of total cumulative FDI in many economies of the region. Recently the weight of intraregional foreign investment among transition economies has tended to grow primarily in terms of the number of enterprises. At the beginning of 1994, the share of foreign partners from transition economies was the most important in Belarus and Ukraine (47 and 51 per cent of total numbers, respectively). In terms of capital they accounted for 19 per cent of FDI stock in Lithuania and 14 per cent in Latvia.

33. In summary, while the number of foreign investment enterprises is impressive, when measured by value the magnitude remains insufficient to have a significant impact on trade and economic restructuring, particularly amongst the small transition economies. Some countries whose enterprises are in the forefront of FDI activities like Japan, are still very poorly represented in the region, which suggests a serious lack of information about opportunities. The orientation of FDI, particularly in economies with little FDI, is predominantly in services, i.e. selling to the local market rather than on

production for exports. There has, however, been a growth in intraregional investment although its size by value and number remains rather small.

34. In greater volumes FDI could play a substantial role in boosting the trade of transition economies. FDI offers a number of tangible and intangible assets to host economies which mobilize their own factors into trading activity. Chief amongst the tangible assets which foreign companies provide are investment capital (they have far easier access to international capital markets than domestic enterprises) and technology. These can contribute to raising the skill and productivity level of the foreign subsidiary to international standards, and thereby make its output internationally competitive. Amongst the intangible assets which foreign firms provide host countries are: a knowledge of markets (derived from these firms' international networks of affiliates); a registered trade mark or a brand-name; marketing know-how; and management skills.

35. It should not be forgotten that indirectly too, investments by foreign companies, particularly in infrastructure like transport and telecommunications, can facilitate the trading potential of the country as a whole while western companies' involvement in non-equity links with companies, particularly sub-contracting, has positive effects on exports.

36. This package of capital, technology, and management skills is particularly needed by enterprises in transition economies. While FDI is only one amongst a number of forms of enterprise cooperation, e.g. licensing, portfolio investment, technical agreements, franchising, etc. it is the only form which transfers all these resources in a single package. All other forms transmit these resources independently.

(a) Importance of attracting the right type of investment

37. While FDI can act as a catalyst for trade promotion and the restructuring of an economy's productive base, the process is, however, not automatic. Beneficial trade effects do not occur simply by a country attracting large FDI flows. In fact, there are several potential problems to which FDI can give rise. These include the possibility that such ventures serve only the home market rather than contributing to exports; that they may threaten the growth of small indigenous firms and lead to monopolistic markets, and may not develop local R & D capabilities.

38. It should be recalled that the flow of FDI in Latin America in the 1970s (behind high tariff walls and protected domestic markets) did not raise output, productivity or exports. In these and other developing countries, complaints were often raised that foreign firms exported too little and imported too much. Indeed, some complaints have been raised in transition economies that the economic contribution of FDI has not been as great as was expected, 3/ while the protection of domestic markets which large western companies in specific oligopolistic industries - cars, telecommunications, tobacco, etc. - have demanded and obtained from Government can distort trade and have negative effects on enterprise restructuring.

39. FDI, it should be noted, has different effects on trade depending on the strategy of the investing enterprise. Essentially, companies invest in a foreign country to: (i) manufacture a good or sell a service to the local market; (ii) to establish a production base for export; and (iii) to extract

natural resources. Market-seeking FDI, tends to have an import-substituting effect. Factor-seeking FDI (particularly but not exclusively, low cost labour) tends to have pro-trade production and consumption effects as production of exports and consumption of imports are expanded. Resource extraction FDI, can have a pro-trade effect if increases of exports are greater than imports.

40. All these types of FDI can create advantages for a host economy, but the second and third types of FDI, from the point of view of expanding the exports of transition economies, can have the best effects for transition economies.

41. However, according to all the surveys of foreign investors, the market seeking-strategy, rather than the other two strategies, appears to be the predominant reason for FDI in central and east Europe. 4/ Several reasons might be adduced to explain this behaviour. First, the high risks of entering these new markets has made companies prefer the safer option of selling domestically than the far harder and riskier option of producing for export. Secondly, FDI has gone into many countries as a result of privatization. Western companies in consumer goods and in some producer goods, for example, have acquired domestic companies with local brands and stable and very large customer bases. They have used these companies to expand the range of brands offered to local customers and to sell their own products. Privatization has reinforced thus the predominantly domestic focus of these enterprises. 5/

42. This "market-seeking" strategy tends to have an import-substituting effect on trade even though the taking over of domestic assets by the foreign company in order to expand its market share, does not preclude the company from selling a part of its production abroad. 6/ Even so, the domestic orientation of the firm will inevitably mean that the export market remains low in the list of priorities.

(b) The importance of FDI in trade restructuring

43. As noted above, restoring the loss of their export potential in higher valued products should be a primary objective of transition economies. To this end, given the advantages of transition economies in certain factor endowments, three product areas can be identified in which FDI can make a contribution to trade and trade restructuring in transition economies:

(i) manufactured goods in medium- and high-technology industries;
(ii) agricultural products;
(iii) raw materials.

(i) Manufactured goods in medium and high technology industries

44. While many expected large western firms to be attracted to the region to exploit low factor costs, particularly of labour, the evidence, as seen from the surveys, suggests otherwise. Cheap labour is not, and will not become a sufficient attraction for western companies to invest the large sums of capital transition economies need. By its nature, it is a fleeting advantage; it will tend to erode as economies grow. Consequently, big western companies do not sink large amounts of capital into plant and equipment only for this reason. In the technology intensive sectors moreover, where large western firms dominate, its importance is exaggerated. Other factors which transition economies possess, skilled labour and basic technologies, are however, a different matter. Here there is far greater scope for western companies to

improve the structure of trade of those larger transition economies with manufacturing and technological capabilities. This will be achieved less by the creation of new technologies and completely new production processes established by these companies in the region, but rather by the upgrading of existing local technological capabilities. 7/

BOX 2
STRENGTHS AND WEAKNESSES OF TECHNOLOGY IN TRANSITION ECONOMIES

Transition economies possess capabilities in many technologies:

- computer software;
- aerospace engines;
- space technology;
- medical equipment technology;
- non-ferrous metal processing and mineral exploration equipment.

On the other hand, the technology of transition economies suffers from a number of weaknesses which impairs their ability to translate these capabilities into international marketable products. These weaknesses concern:

- inferior products (because technology was often not allied to production the products were usually far inferior to the technology);

- no facilities or no conception to enter into mass production;

- little understanding of the concept of production cost;

- inadequate funding: companies tend to be large-scale and dependent on the State budget for their finances;

- inadequate awareness of the environmental considerations which are in the west forging new products at a rapid pace.

Source: Various ind. Technology News; Military Technology; Aerospace Magazine.

45. Western partners are in a good position to take advantage of the technological capabilities shown in Box 2 and at the same time rectify shortcomings and weaknesses. Already in central European countries the first signs of this east-west cooperation is bearing tangible fruits for the host economies. In Poland, Asea Brown Boveri (ABB), the Swedish-Swiss electrical engineering company, following its takeover of several local companies, has been building on the existing technology of these enterprises, upgrading their production techniques and locating the manufacture of certain of its products for its European markets in Poland. ABB now has begun producing for the first time in Poland gas powered generators, which because of their environmental benefits over coal fired generators are much in demand in world markets. In Hungary, General Electric of the US, having acquired Tungsram, the light bulb

manufacturer, now produces energy-saving lights for its world-wide markets in Hungary - a product for which it had formerly no technology and which is also much in demand because of its environmental benefits. In the automobile industry, substantial investments have been made by western car companies creating an industrial capability which did not exist prior to the systemic changes in Hungary.

(ii) Agricultural products

46. In small agricultural-based, transition economies, FDI has a role to play in processing and upgrading the qualities of products, particularly in the areas of packaging, bottling, canning and labelling. In several transition economies, western companies have established plants to process local fruit into juices for western markets.

(iii) Raw materials

47. The abundance of non-renewable raw materials such as oil and gas at low cost is highly attractive to western companies who can assist in the transport and infrastructural development to get these products to western markets. In the oil sector the value of deals concluded is still rather small; larger ones are still under negotiation. The few projects which have begun operations trade in oil rather than produce it. Ideally, the value in the trade of raw materials would be enhanced if foreign companies helped in the processing of the material before its export.

48. Although it is still early to see substantial industrial and trade restructuring arising from FDI, there is still evidence from individual cases of large company investment of the upgrading of the structure of exports. In this respect FDI can play an important role in assisting the transition economies in improving the commodity structure of exports and shifting towards more sophisticated, higher-value added categories of exports. It can thus assist transition economies in halting or reversing the trend identified above of a shift in the commodity structure of their trade to relatively less-processed goods.

(c) Need for appropriate measures to attract trade-enhancing investment

49. A package of measures is required to attract export-enhancing investment:

(i) Basic principles

50. Many of the transition economies are small economies which are handicapped in attracting FDI by the lack of a big domestic market. They will thus have to develop a most hospitable FDI environment even more so than larger neighbouring countries, and at the same time rely on their comparative advantages to attract export-oriented FDI. As a corollary, they will have to adopt an outward-oriented trade policy, that strongly encourages exports. Without such a policy, these countries will shut themselves out of the bulk of potential FDI flows.

(ii) Eradication of weaknesses

51. Policy makers must try and eradicate existing weaknesses in their legislation and regulations dealing with foreign investors:

- use of protectionism to attract FDI; while protectionist policies - use of import tariffs, exclusive seller arrangements, etc. - attracts foreign direct investment (in Poland FDI-intensive industries have average tariffs on imports that are 66 per cent higher than in manufacturing as a whole), 8/ protected firms have no incentive to export. Such measures should thus be used, if at all, selectively and with a clear timetable for their elimination. 9/

- frequent changes to the legislative and fiscal environment, for instance, the uncertainty caused by frequent changes in Government policies and regulations and reflecting often the non-systemized and piecemeal approach to legislative development, is perceived to be a major problem and deterrent to investment in central and eastern Europe. In some countries, particularly amongst the Newly Independent States, inflows of FDI cannot be expected until the necessary legislation has been developed.

- slowness in implementing privatization; the countries of the region which have been the most successful in attracting FDI have been the ones which have made the most progress in privatization.

- land laws and inadequate protection of property rights directly impede export-oriented investments. Direct ownership of land by foreigners is not permitted in the transition economies or is made difficult by inadequate or non-existent land registration systems. Securing property rights, the development of collateral laws and institutions that support the financing of foreign businesses should be a priority for countries in the region.

- bureaucratic inflexibility. While some countries may have waived formal approval procedures for foreign companies, there are at the local level numerous time-consuming hurdles, e.g. local planning permission that must be obtained before production is permitted. In addition, petty rules and regulations still exist which can affect the unsuspecting foreign investor. 10/

- Customs complications; speedy and easy repayment of Customs duties is required if firms are to be encouraged to import goods for processing for export; 11/

- insufficient incentives; targeted incentives should be provided for companies that export. 12/

(iii) Development of an investment promotion capability

52. Aside from eradicating these and other weaknesses, policy makers will have to devise a strategy of FDI promotion. This strategy should consist of the following elements:

- facilitation and service activities aimed at assisting potential investors into operation, e.g. providing potential investors with a range of information services; ensuring that all permits and approvals are provided quickly, etc.;

- investment promotion and generation activities aimed at identifying and encouraging more potential investors, e.g. targeting sectors and even companies as recipients of FDI and countries and investors as sources of FDI;
- image building activities aimed at enhancing the image of the country among potential investors; 13/
- strategies to promote FDI from the small- and medium-sized enterprise (SME) business sector. SMEs as a rule compete more on cost and price and are thus more interested in establishing production units using low factor cost, particularly of labour, in transition economies and to export back to their home markets. 14/

(iv) Institution and staffing

53. A revamped institution to deliver these services and develop a strategy for FDI promotion is required. It is inadvisable for Governments to diffuse FDI promotion and regulatory activities to a large number of agencies. Ideally, authority should be given to a single coordinating agency. Research shows that foreign investors prefer to deal with a strong central agency - like the Economic Development Board of Singapore. As with this latter agency, Governments might also consider introducing performance-related pay systems to encourage employees in seeking to attract FDI in their respective countries.

4. Improvements in the settlement of payments and financing mutual trade

(a) Deficiencies in Trade Finance

(i) Situation and problems

54. Within the CIS, payments and trade financing constitute a major obstacle impeding the development of trade. In spite of considerable progress made in strengthening national currencies and central bank policies, national currencies are still largely non-convertible, foreign exchange reserves remain small, and exchange controls tight. As a result, there are problems affecting mutual trade and services transactions in particular, causing substantial delays in payments, a high risk of non-payment and high transaction costs. Export credit insurance is generally not available for CIS companies. The most frequent methods of payment are letters of credit and cash in advance, which are both expensive. At the macroeconomic level, the inconvertibility of the new national currencies, combined with the lack of hard currency, has led to the development of bilateral barter trade. Only bilateral clearing is possible between commercial banks of CIS countries which have concluded specific agreements. The structural trade imbalances the Newly Independent States (NIS) inherited from the Soviet era cause acute problems.

55. In the central and east European countries, full current account convertibility was achieved everywhere except in Albania and in Bulgaria. However, the institutional conditions for an efficient payments system are far from optimal, and the banking sector in particular is not yet able to fulfil the payment and trade financing tasks it performs in the west. One of the main problems arising in this respect is that the central and east European countries' banks are often crippled with bad loans. Indeed many central and east European banks have a few large borrowers on their books who will never

be able to repay their debts. The loss of confidence in bank solvency has thus contributed to worsen the payments and trade financing problems. Virtually all payment arrangements now take the form of confirmed or unconfirmed letters of credit and some countries are not eligible for export credit insurance.

(ii) Options and actions

a. Newly Independent States

56. Since the rouble zone does not exist any more, the NIS are left with few alternatives to improve the situation. A few options have been discussed including the creation of (i) a rouble area; (ii) a multilateral clearing system; and (iii) a payments union. 15/ It must be stressed that the three options can go in parallel with moving towards greater convertibility.

i. Creation of a rouble area

57. In a rouble area the Russian rouble would serve as a currency peg, so it would not alter the newly acquired monetary independencies. As was the case within the sterling area, a group of countries with different currencies would continue to use the former leading currency for international purposes, even after establishing monetary independence. The main drawback to this solution is that the rouble is not yet a stable currency, which would be an important pre-condition for such an arrangement to work.

ii. Creation of a multilateral clearing system

58. A multilateral clearing system would economize on the use of hard currency by permitting transactions at the enterprise level to be conducted in national currencies. The regional clearing centre would convert all transactions into a common unit of account (the ECU for instance), calculate periodically the net balances between partner banks and establish at the end of the settlement period the multilateral net debit balances arising from all the transactions during the period. Only at the end of that period would central banks settle their net debit balances by transfers in convertible currency to the net creditor banks. Such a system would allow NIS to save hard currency since only the net imbalances would have to be cleared in convertible currency. As most of the NIS trade is intra-CIS, this saving of reserves would in turn help the NIS moving towards convertibility.

iii. Creation of a payments union

59. The creation of a payments union would go one step further than a multilateral clearing system, as intra-CIS imbalances could be cleared through credits instead of transfers of convertible currency. The need for hard currency is therefore lower in a payments union than in a clearing system.

60. The final option, while at first appealing, suffers from some drawbacks. First, the existence of high inflation is an important barrier for the implementation of any of these latter two solutions, since the adoption of the national currencies' exchange rates with the common unit of account would be very difficult. Therefore, achieving a greater degree of macroeconomic stabilisation should be the primary objective of the NIS regarding the payments issue. In addition, the structural trade imbalances would also constitute an important obstacle since they would generate a rapid exhaustion

of the structural deficit countries' reserves. A possible solution would be the initial and temporary exclusion from the clearing system of the commodities generating the structural imbalances. 16/

61. These drawbacks notwithstanding, the CIS authorities have continued to investigate the creation of a payments union. On 21 October 1994, a regional economic union agreement was agreed upon by the CIS heads of States, which provides among other things for the establishment of a payments union. However the signed documents only constitute a framework agreement, with no calendar or binding provisions. Because of the above-mentioned problems, the rapid implementation of such a project seems rather optimistic.

b. Central and East European Countries

62. The central and east European countries have to improve the situation of the banking and financial sector and move towards greater convertibility. The main issues are thus to improve the legal environment for financial institutions, to carry on with tight macroeconomic policies in order to keep inflation under control, and to try to channel the international assistance to the sectors where it can be used most efficiently.

63. In 1994, the situation in the financial sector prompted a group of central and east European banks, including one from Russia, to establish a multilateral clearing system based on Ecu settlements. To fund trade-related payments, the central and east European banks will maintain accounts in convertible currency with their five western clearing partners. These will be drawn on by the clearing bank following the paying bank's instructions. This system should accelerate actual payments and contribute to the restoration of mutual trust between central and east European trading partners.

64. International assistance directed at improving the financial sector already comes mainly from the EU. Furthermore, the European Council decided in December 1994 in Essen that the EU would launch a new initiative to facilitate trade in the region, with a view to contributing to the realisation of the Pact for Stability. This initiative will include, among other things, some technical assistance for the development of export insurance and guarantee schemes, possibly in association with the EBRD.

c. Trade finance

65. Trade financing continues to be either difficult or impossible in most transition economies. Only in a very few east European countries can domestic banks offer guarantees which are acceptable to western banks.

66. **Risk** is the principal source of transaction costs in trade finance. Its main sources are the weakness of firms and financial institutions and country risk (caused by the unpredictability of political, macroeconomic and regulatory conditions). These risks are real. Markets legitimately force a greater share of the responsibility for financing trade on risky countries, and on the weak exporting or importing firms within them. Local banks are reluctant to lend to or underwrite risk on many firms, and foreign correspondent banks display the same reluctance vis-à-vis those local banks. Since risk is a function of exposure and duration, trade finance is correctly biased towards short maturities (in the extreme, cash or even cashless barter operations in many countries of the CIS), and against larger transactions.

67. However, the economic consequences of risk are magnified in many of the countries of the former Soviet Union by the markets' inability to measure and manage risk. Risk assessment and mitigation is hampered by information deficiencies, incomplete legal frameworks and a lack of insurance. The information "institutions" (and related skills) that support credit markets elsewhere are largely missing. Local banks often cannot assess the risk of local firms. Correspondent banking relationships are hampered by a lack of track record (of both institutions and countries), the most common source of credit information. Legislation on secured transactions is often not sufficiently developed to allow the use of collateral other than cash deposits. The development of (export) credit insurance policies, which often substitute for other collateral in market economies, is embryonic at best. Among other problems, it is stifled by the shallowness of financial markets that renders the effective pooling of risks very difficult.

68. For certain import transactions in certain countries, insurance is available from foreign export credit agencies; however, coverage is still patchy and does not genuinely allow for market-based decision-making by former Soviet Union firms because of restrictions on sourcing. The limited coverage available is generally restricted to short term transactions and to operations that benefit from sovereign guarantees or that are conducted with institutions that are believed to represent quasi-sovereign risk.

69. Apart from reinforcing the short-term bias of trade finance, these problems prevent risk from being priced, resulting in the rationing of credit at both the internal (bank-firm) and external levels (bank-foreign correspondent). Even though the underlying transaction may be sound, local banks often demand full cash collateral for issuing letters of credit or payment and performance bonds. This is not always caused by a shortage of liquidity. Foreign banks impose the same conditions for confirming instruments issued by former Soviet Union banks, as well as for effecting payment services.

70. Conditions for financing trade have become worse since the 1980s. In short-term trade, for London-based banks, confirmed letters of credit or cash-in-advance are now recommended for trade with the majority of transition economies while unconfirmed letters of credit were the norm in the mid-1980s. However, for seven countries (most in the CIS), confirmation by western banks is generally unavailable; for 10 others full cash collateral together with a maximum 12 per cent confirmation fee was recommended in mid-1994. Commercial medium- to long-term refinancing is practically unavailable to former Soviet Union countries and conditions are if anything worse in intraregional trade.

71. Nevertheless, it is worth emphasizing that some of the more irregular techniques that can be observed in trade finance, such as barter and a prevalence of cash transactions, are not rooted solely in risk but often in Government regulations as well (and in some cases in inter-enterprise arrears).

72. The burden of the resulting transaction costs is unevenly distributed. In fact, in certain sectors, between certain countries and involving certain firms, short-term trade finance is flourishing. Informal enforcement structures "mitigate" the information problems in some countries. Trade in natural resources is sometimes easier to collateralize, and some firms in this sector have built up substantial bank deposits abroad. Large, traditional

enterprises face less constraints when dealing with their banks, and sometimes own foreign subsidiaries. Trading firms, including some of the former monopolies, have the networks and capital that allow them to bypass or intermediate with the financial sector and provide other services (often at a high cost, and leaving the risk with the firm). Small emerging firms in the private sector are often penalized since they face most acutely the information constraint. So are exports of goods with a substantial gestation period (pre-shipment finance), and imports of capital goods (investment finance by banks or suppliers). Trade among countries of former Soviet Union, in particular intra-CIS, is subject to additional risk and uncertainty.

G. CONCLUSIONS

Diagnosis of the problem

73. Thanks to the rapid liberalization of trade in their own countries and to the conclusion of preferential trade agreements with some western market economies, new trading opportunities have been created for exporters in transition economies. These opportunities are set to increase as the agreements of the GATT Uruguay Round are put into effect. So far, some exporters from transition economies have managed to take advantage of these new trading opportunities, have shifted their trade from the old CMEA markets to new western ones and are now competing in these markets on an entirely new basis. However the trade of the transition economies has also seen:

- a decline in the global value of exports;
- a shift in the commodity composition of exports to low-value, raw and semi-processed goods;
- a decline in intraregional trade.

These developments cast serious doubts as to whether the success of some central European and Baltic countries can be sustained, and whether it can be enlarged to include trading firms from the CIS.

74. The trading performance of transition economies reflects different sets of factors at various levels. At the level of the firm, enterprises suffer from low productivity, management and human resource-related problems, obsolete plant and equipment, poor quality products and inadequate marketing and exporting skills. At the national level, enterprises lack: a properly functioning financial sector to facilitate payments, provide loans and trade finance; information services from a trade promotion agency; and in some cases, a suitable legal and regulatory framework that protects property owners and enforces contracts. At the international level, market access conditions continue to affect exporters from the transition economies, and especially those from the CIS. As a result of anti-dumping actions, CIS countries have suffered significant losses in export revenues. In sensitive sectors as well (i.e. agriculture, steel textiles and chemicals), the use of non-tariff and other technical barriers by western Governments also has a negative impact on their export performance.

75. It is hard accurately to measure the salience of these sets of factors. The importance of these trade barriers to exporters in transition economies

clearly depends on both the industry and the country. According to surveys of exporters in the transition economies which were carried out by the UN/ECE and also by the OECD, the supply side problems seem to constitute the main barriers to trade. Nevertheless, the external barriers and market access problems cannot be ignored. Aside from losses in export revenues, the mere existence of these restrictions can have serious trade and investment-deterring effects.

Prerequisites for building successful trade regimes

76. Improvement in the performance of the trade regime is crucially linked to the transition economies' progress in economic and structural reform.

77. There are two basic and related prerequisites for building successful trade regimes. The first prerequisite is the pursuit of macroeconomic stabilization. Only by controlling inflation and reducing public deficits can an environment be created in which market operators have the necessary confidence to invest.

78. The second prerequisite of a successful trade regime is privatization. State-owned enterprises do not have the proper motivation for undertaking trading activities. Private sectors should be promoted, particularly the small- and medium-sized business sector. Moreover, State intervention in foreign trade transactions should be eliminated in those transition economies where state trading and centralized and administration management is still strong.

79. These prerequisites do not imply the withdrawal of the Government and the State from foreign trade activities. Private sectors are still too underdeveloped and vulnerable for Governments to adopt laissez-faire policies. Rather, Governments must adopt a proactive role in creating the right conditions for private companies to develop comparative advantages and compete abroad in export markets. Aside from establishing a suitable regulatory and commercial framework and a financial system that provides loans, export finance and guarantees to exporters, Governments will have to provide direct services to traders to enable them to compete in international markets.

80. Protecting selected companies from international competition as a means of promoting exports should be avoided. The experience of successful State involvement in trade in the economies of East Asia after the Second World War is not easily translatable to the specific situation of transition economies. Government officials would also face major difficulties in selecting these industries to protect, since comparative advantages would have to be identified without accurate statistical information on prices, trade and production.

Objectives and priority policy measures

81. Decisions about trade policy should be predicated on what Governments are seeking to achieve in the trade field. In transition economies, these objectives should include:

- increasing the global value of exports;
- developing a presence on western markets;

- promoting intraregional trade;

- improving the commodity composition of exports.

82. Faced with all the problems they have to deal with and lacking sufficient resources to undertake all the measures they should or could adopt, Governments of the transition economies will have to fix a core set of priorities which should be implemented straightaway, and other measures which could be put into effect later on.

83. For the CIS the main priorities should be:

- the improvement in the payment system: the creation of a multilateral clearing system is urgently needed. The related provisions contained in the CIS agreement of 21 October 1994 should thus be implemented as soon as possible;

- the fostering of trade liberalization by removing trade barriers on mutual and external trade;

- creating trade promotion and trade facilitation institutions;

- introducing modern Customs procedures, facilitation and equipment;

- adopting a common system of standards and certification, based on global standards whenever possible;

- establishing a stable commercial framework with emphasis on legal enforcement and the protection of property rights.

84. Non-CIS States will have different priorities given that they are generally more advanced in economic and trade reform. Their priorities should focus on the following:

- developing and extending intraregional free trade agreements;

- making export-related information more accessible;

- enforcing the newly created legal frameworks for private sector business;

- developing trade finance institutions;

- encouraging export-oriented FDI.

85. Implementing these conditions is essential in preparing the groundwork for the accession of transition economies to the World Trade Organisation.

86. Western market economies have an important role to play in supporting transition economies implement these priority policy measures. In particular, their assistance should focus on:

- removing remaining trade barriers, by in particular improving the transparency in anti-dumping actions and market access conditions for agricultural products from the transition economies;

- concerning the EU, extending preferential trade agreements to other transition economies (i.e. CIS States, Albania and former Yugoslavian Republics);

- assisting transition economies in institution building, particularly focusing on trade and investment promotion and trade facilitation.

Second-stage support measures, infrastructural projects and the role of foreign direct investment

87. Having dealt with the most urgent priorities, the transition economies, with assistance from various international institutions, should try to promote a series of support projects at the enterprise level. These should include:

- measures to build up the response of the enterprise sector to the new trading opportunities;

- organization of economic cooperation between SMEs;

- improving the negotiating skills of commodity exporters;

- increasing the channels for western technical assistance into private sector firms;

88. Feeding into these core priority tasks and second stage micro-level projects should be policies designed to improve the infrastructures for trade, notably telecommunications, transport and energy. To bring these infrastructures up to modern standards will require large sums of capital investment, that Governments - even with the assistance of multilateral lending agencies - will not easily be able to raise. Governments should therefore consider the sale of their utilities to private operators as a means of raising the necessary finance.

89. Foreign direct investment can play a major role in trade particularly in upgrading the exports of transition economies. However, the impact of FDI in transition economies on trade has not been beneficial in all cases. In some transition economies, large western firms, when making substantial investments, have obtained higher protective import tariffs as compensation for the perceived higher risks of doing business in the region. Governments should not encourage these types of investment since they have significant anti-trade effects. Governments might consider refocussing their investment promotion efforts towards the western SME sector. While SMEs are unlikely to bring in as much investment capital as large firms, they are generally more sensitive to the advantages of using low-cost labour for export-oriented production and they are more likely to contribute to the expansion of trade in the transition economies.

Notes

1/ In Hungary, for example in September 1993, the Government established ITO Hungary to support export-oriented production initiatives.

2/ The contribution of FDI to export growth in Hungary may be misleading in that the performance of foreign companies is being compared with that of domestic companies whose exports contracted by almost a third (30 per cent) in 1991, recovered only slightly in 1992 and fell by a further 13 per cent in 1993. Also, foreign companies may have been obliged to export when faced with the unexpected low customer demand for their products due to the recession in Hungary and other countries in the early 1990s. Thus their contribution to exports may therefore be temporary.

3/ Gábor Hunya argues that Hungary's current account deficit has been made worse by the country's success in attracting FDI. "Foreign Direct Investment", The Vienna Institute Monthly Report, 1994/12.

4/ See "Survey on Foreign Direct Investment", EBRD Transition Report, 1994.

5/ There are however some more recent positive signs that suggest that foreign companies' strategies are changing. Small- and medium-sized companies, who tend to be more sensitive to cost factors than large companies and are attracted by cheaper labour in the region, are becoming more active in east Europe in production for export. Foreign investors, too, are beginning to rethink the potential of greenfield investments (greenfield investments have a stronger export potential than acquisitions but have not been the common mode of entry into east European markets) in central and eastern Europe both because the number of attractive privatization targets is declining and because of the cost of restructuring former state-owned enterprises. Implementation of these strategies will contribute more favourably to export growth in the transition economies.

6/ Asea Brown Boveri's strategy in acquiring companies in Poland was primarily to boost its sales in the country by having a local manufacturing presence; but in 1993 over 20 per cent of its production was exported, the equivalent of US$ 55 million, which corresponded to 0.5 per cent of Poland's total exports for that year.

7/ If one looks, for example, at economic development in successful advanced economies, one notes that success has been established on access to western technology allied to the constant upgrading in product and process technology. Japan, for example, began in the 1950s with simple labour-intensive manufactures such as textiles, toys and basic electrical appliances; they moved in the 1960s into the scale-intensive manufacture of non-differentiated products such as heavy chemicals, steel, aluminium, shipbuilding and synthetic fibres; they developed, in the next stage, mass production and export of consumer durables such as motor vehicles and electronic goods (still assembly based activities but grounded on high-tech production techniques and growing technological sophistication). This country is now entering a fourth stage in which production and exports are highly research based, in accordance with its new role as an emerging technology world leader. At each stage Japan, utilizing international technology, was able to build on its existing comparative advantage. Such a strategy, with some variations, has been important in the successful growth and integration not only of Japan, but other Asian countries like Korea and Singapore, as well. East European countries, while having vastly different endowments, have the technological potential to achieve the same results.

8/ The corresponding figure for Hungary is 10 per cent, but Hungary uses quantitative restrictions more than Poland. When non-tariff barriers are taken into account, the strong connection between a high degree of protection and high levels of FDI is also apparent in Hungary.

9/ In assessing the general economic consequences of protectionism in the car industry, it can be demonstrated that protection of this kind leads to losses in consumer welfare (under the protection of high import tariffs, VW-Skoda increased its prices six times since 1991) and losses in national welfare offset by real gains in national income from having internationally competitive firms active in the country. The key question is whether once trade barriers are removed companies will be able to compete both domestically and internationally.

The trade impact of protectionism on the Czech, Hungarian and Polish car markets can be summarized as follows:

(i) a fall in car imports in each of the three markets;

(ii) a high proportion of domestic sales accounted for by local firms (60 per cent in Hungary; 80 per cent in the Czech Republic and Poland);

(iii) a concentrated domestic production but a steady increase in the share of exports in domestic production;

(iv) a very low share in new registration accounted for by imports from non-EU countries, particularly from Japan;

(v) little displacement from west to east in trade given the rather small size of the total number of cars being produced by foreign-owned companies in the region (400,000 units).

10/ For example, Daewoo from Korea, which set up a plant in Poland to manufacture television sets for western markets had to pay a fine for not filling out a VAT declaration form correctly.

11/ In Poland the companies must record their imports separately at each Customs crossing and are obliged to wait inordinately long periods of time before getting paid.

12/ Some foreign companies complain that even where these incentives exist, the Government is either slow or fails to provide them.

13/ Depending on their state of preparedness, governments may wish to set priorities according to when they will implement these elements. It is logical to assign top priority to facilitation as such services should be firmly established first so that the maximum possible number of potential investors be effectively converted into actual investors. Image building may have to wait until other elements, particularly regarding the legal framework, are in place.

14/ According to the President of Germany's 7,500-member Association of Independent Entrepreneurs, most small- and medium-sized manufacturing companies are now investigating sourcing from central European locations. "Europe: the Move East", Business Week, 7 November 1994.

15/ See J. Williamson "Trade and Payments after Soviet Disintegration", in Williamson, J., (Ed.), Economic Consequences of Soviet Disintegration, Institute for International Economics, Washington DC, 1993, pp. 576 ss.

16/ UNCTAD "Steps to Improve the Payments System for Regional Trade in Goods and Services", summary of paper prepared by Mr. Y. Konstantinov and Mr. M. Serafarov for the Regional Workshop of CIS and Baltic States at the Ministerial Level on the Development of Regional Trade and Enterprise Cooperation and Major Challenges of Increased Participation in International Trade, 9-13 January 1995, Kishinov, Republic of Moldova.